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The Role of Corporate Governance in Enhancing Performance and Reducing Corporate Risk: The Case of the UK Banking Sector

Abstract

This study aims primarily to assess the overall impact of corporate governance on corporate performance and corporate risk within the UK banking industry. More specifically, it investigates the influence of corporate governance on two important dimensions, these being: how a firm is performing in terms of financial and operational issues, and corporate risk in terms of liquidity and capital. The thesis will make a contribution to the existing body of theoretical literature pertaining to corporate governance in the UK banking-sector with respect to corporate governance performance relationships. To achieve this aim, the study undertakes a comprehensive literature review from which several hypotheses on the relational significance of corporate governance and corporate performance measures are developed. It then adopts a quantitative approach in which UK bankers and capital market brokers are surveyed to obtain primary data to use for testing those hypotheses. The testing is performed using econometric models and statistical analyses, from which the corporate governance trends are revealed. The outcomes have serious implications for the managements of banking companies as they demonstrate the importance of particular corporate governance variables, and recommend attention to the size of the board, board composition, the establishment of board committees, and the ownership structure of UK banking companies. In addition, several potential areas for further research are identified and reported.

**The Role of Corporate Governance in Enhancing
Performance and Reducing Corporate Risk:
The Case of the UK Banking Sector**

Submitted By

Samia Alenazi

For the Degree of Doctor of Philosophy
Thesis Submitted to the Durham University of 2016

Table of Contents

Abstract	1
Table of Contents	3
List of Tables	7
Declaration	10
Statement of Copyright	11
Acknowledgements	12
Chapter 1: Introduction	13
1.1 <i>Introduction</i>	13
1.1.1 Definition of Corporate Governance.....	13
1.1.1.1 Corporate Governance.....	14
1.1.2 Corporate Governance Model.....	16
1.1.3 Accounting and Corporate Governance: The Main Link.....	17
1.1.4 Characteristics of Banks and their Impact on Corporate Governance.....	17
1.2 <i>Background Information</i>	18
1.3 <i>Overview of the Corporate Governance Models</i>	19
1.3.1 The Agency Model.....	19
1.3.2 The Stewardship Model.....	20
1.3.3 The Stakeholder Model.....	20
1.3.4 The Political Model.....	21
1.4 <i>Motivation for the Study and Contribution</i>	21
1.4.1 Motivation.....	21
1.4.2 Contribution of this thesis.....	24
1.4.3 Significance of Corporate Governance.....	25
1.4.4 Risk Management.....	27
1.5 <i>The Study Scope</i>	28
1.6 <i>Objectives of the Study</i>	28
1.7 <i>Research Questions</i>	29
1.8 <i>Findings of the Research</i>	30
1.9 <i>Structure of the Thesis</i>	31
Chapter 2: Literature Review	32
2.1 <i>Introduction</i>	32
2.2 <i>The Global Financial Crisis</i>	32
2.2.1 Crisis in UK Banking.....	37
2.3 <i>The Business of Banks</i>	40
2.4 <i>Differences between Corporate Governance in Banking Institutions and in Non-Financial Entities</i>	44
2.5 <i>Dimensions of Corporate Governance</i>	46
2.6 <i>Corporate Governance Mechanisms as a Means of Controlling the Agency Problem</i>	49
2.7 <i>Corporate Governance Codes in the UK</i>	54
2.7.1 The Principles-based and Rules-based Approaches.....	54
2.7.2 Evolution of Corporate Governance in the UK.....	56
2.7.3 Introduction of Combined Codes of Corporate Governance.....	58
2.7.4 Flexibility in Corporate Governance Practices.....	59
2.7.5 Independence of the Directors and Corporate Governance.....	60
2.8 <i>Corporate Governance and Firm Performance</i>	62
2.8.1 The Impact of Governance Practices on Corporate Performance.....	63
2.8.1.1 The Board of Directors.....	64

2.8.1.2 Board Composition	66
2.8.1.3 Non-Executive Directors and Executive Directors	68
2.8.1.4 Role Duality.....	74
2.8.1.5 Board Size.....	75
2.8.1.6 Board Meeting Frequency.....	77
2.8.1.7 Ownership Concentration and Corporate Performance	78
2.8.1.8 Risk Management.....	80
2.8.1.9 Other Board and Company Characteristics	82
2.8.1.10 Summary.....	86
2.9 Corporate Governance and the Overall Issue of Risk Management.....	87
2.10 Corporate Governance, Ownership and Risk-taking in Banks.....	87
2.11 Corporate Governance and Enterprise Risk Management	88
2.12 Corporate Governance and Risk Management.....	88
2.13 Studies Informing the Literature Review.....	90
2.14 Conclusion	106
Chapter 3: Conceptualising Corporate Governance	108
3.1 Introduction	108
3.2 Agency Theory.....	108
3.3 Stakeholder Theory	113
3.4 Stewardship Theory.....	121
3.5 Resource Dependency Theory.....	124
3.6 Transaction Cost Theory (TCT).....	126
3.7 Political Theory	128
3.8 Legitimacy Theory	131
3.9 Summary.....	133
3.10 Conclusion	134
Chapter 4: Research Design, Methodology, and Hypotheses Development.....	136
4.1 Introduction	136
4.2 Research Philosophy.....	137
4.2.1 Positivism	138
4.2.2 Interpretivism	140
4.3 Research Approach.....	143
4.4 Choice of Research Philosophy and Approach.....	144
4.5 Research Paradigm.....	146
4.6 Research Methods.....	147
4.6.1 Survey Method	148
4.6.2 Research Methods Selected for the Study.....	149
4.7 Method of Data Analysis.....	149
4.8 Research Design	150
4.8.1 Rationale for the Selection of Bankers and Brokers	152
4.9 Econometric Models of Corporate Performance and Risk	153
4.9.1 Board Size	153
4.9.2 The Effect of Board Size on Corporate Governance.....	154
4.9.3 The Impact of Role Duality on Corporate Performance and Risk	156
4.9.4 The Impact of Board Composition on Corporate Performance and Risk.....	158
4.9.5 The Impact of Board Meeting Frequency on Corporate Performance and Risk (DROPPED)	161

4.9.6 The Impact of Audit Committee Size and Constitution.....	163
4.9.7 The Impact of Remunerations and Nominations Committee	164
4.9.8 The Impact of the Risk Management Committee (dropped)	166
4.9.9 The Impact of Ownership Structure on Corporate Performance and Risk	167
4.9.9.1 Free Float.....	167
4.9.9.2 Block-holders	168
4.10 Control Variables	168
4.11 Research Questions	169
4.12 Model Specification.....	170
4.13 Conceptual Regression Model for Performance.....	172
4.14 Conceptual Regression Model for Corporate Risk	173
4.15 Data and Variables: Definition and Measurement	174
4.15.1 Performance Measures	174
4.15.2 Study Variables	175
4.16 Endogeneity and Causality Problem	177
4.17 Conclusion	179
Chapter 5: Empirical Results and Analysis	181
5.1 Introduction	181
5.2 Missing Data	181
5.3 Data Transformation	184
5.4 Variable Correlations	189
5.5 Comparing Variables Before and After the Crisis.....	192
5.6 Categorical Variables Before and After the Crisis	196
5.7 Regression Models	197
5.8 Regression Model for Return on Assets	197
5.9 Regression Model for Return on Equity.....	199
5.10 Regression Model for Liquidity Risk (Square Root)	200
5.11 Regression Model for Capital Risk (Square Root)	203
5.12 Interpretation and Discussion	204
5.12.1 Effect of Variables on Performance as measured by ROA and ROE	204
5.13 Effect of Variables on Risk as measured by LR and Carisk.....	206
5.14 Discussion in the Lights of Theories	208
5.15 Conclusion	212
Chapter 6: Survey Response Analysis	214
6.1 Introduction	214
6.2 Overview	214
6.3 The Survey Instrument, Response, Demographics, and Descriptive Statistics	215
6.4 Hypotheses Testing	222
6.4.1 Statistical Methodology	222
6.4.2 Corporate Governance and Performance	223
6.4.3 Corporate Governance and Corporate Risk.....	227
6.5 Discussion.....	231
6.5.1 Corporate Performance.....	231
6.5.2 Corporate Risk.....	234
6.6 Comparing the Questionnaire and Empirical Investigation Results	237

6.6.1 Corporate Performance.....	237
6.6.2 Corporate Risk.....	238
6.7 Conclusion	240
Chapter 7: Conclusion	245
7.1 Introduction	245
7.2 Results and Findings	246
7.3 Recommendations and Implications of the Study	248
7.4 Limitations and Future Research.....	249
Appendices	251
Appendix I: Questionnaire	251
Appendix II: Real GDP Growth Trends in the World Before, During and After the Global Financial Crisis (2005-2015) (%).....	256
References	258

List of Tables

Table 0.0: List of Abbreviations.....	09
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Chapter 1

Table 1.1 Bank Oriented Corporate Governance System vs. Market Oriented Corporate Governance System.....	15
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Chapter 2

Table 2.1: Internal and External Mechanisms of Corporate Governance.....	52
Table 2.2. Substitutability and Complementarity of Corporate Governance Mechanisms	54
Table 2.3: Summary of Responsibilities of Board Members	72
Table 2.4: Board Characteristics.....	83
Table 2.5: Risk Taxonomy	89
Table 2.6: Studies Informing the Review	91

Chapter 3

Table 3.1: Attributes of Bank Oriented and Market Oriented Corporate Governance System and its Impact on Stakeholders	117
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Chapter 4

Table 4.1: Features of the Positivist Paradigm	140
Table 4.2: Features of the Interpretivist Paradigm.....	141
Table 4.3: Summary of Research Techniques.....	148
Table 4.4: Summary of the Terms of Measurement	176

Chapter 5

Table 5.1: Imputed Missing Values	183
Table 5.2: Descriptive Statistics for Variables Before and After the Crisis	186
Table 5.3: Pearson Correlations of Analysis Variables.....	191
Table 5.4: T-Test Comparisons of Analysis Variables Before and After the Crisis	194
Table 5.5: Chi-Square Analysis of Categorical Variables Before and After the Crisis	196
Table 5.6: Model of ROA.....	198
Table 5.7: Parameter Estimates	198
Table 5.8: Model of ROE.....	199
Table 5.9: Parameter Estimates	200
Table 5.10: Model of Liquidity Risk (Square Root)	201
Table 5.11: Parameter Estimates (Excluding Control Variables): Model of Liquidity Risk (Square Root).....	201
Table 5.12: Model of Capital Risk (Square Root)	203
Table 5.13: Parameter Estimates (Excluding Control Variables): Model of Capital Risk (Square Root).....	204

Chapter 6

Table 6.1: Survey Response Rates	216
Table 6.2: Demographic Characteristics of the Sample	217
Table 6.3: Corporate Performance Questions: Descriptive Statistics.....	219
Table 6.4: Corporate Risk Questions: Descriptive Statistics	220
Table 6.5: Corporate Governance and Corporate Performance – Results of the Wilcoxon-Mann-Whitney Test.....	224
Table 6.6: Corporate Performance Questions: Mann-Whitney U test comparisons of Bankers and Brokers.....	226

Table 6.7: Corporate Governance and Corporate Risk	228
Table 6.8: Corporate Risk Questions: Mann-Whitney U test comparisons of Bankers and Brokers	230

Table 0.0: List of Abbreviations

Abbreviation	Definition
AC	Audit Committee
AC-NED	NEDs on the Audit Committee
ACM	Audit Committee Meeting
BH	Block-holdings
BM	Board Meeting
B-NED	Non-Executive Directors
BS	board size
Caprisk	Capital Risk
cross listi	Cross Listing
FF	Free Float
Firmage	Firm Age
GFC	Global Financial Crisis
Growth	Average assets growth
Intangible A	Intangible Assets
Liqrisk	Liquidity Risk
NOMC	Nomination Committee
RD	Role Duality
REC	Remuneration Committee
RMC	Risk Management Committee
Roa	Return on Assets
Roe	Return on Equity

Declaration

This is to attest that no material from this thesis has been included in any work submitted for examination at this or any other university.

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Chapter 1: Introduction

1.1 Introduction

In the current turbulent economic environment, every organization strives for excellence in handling corporate issues and its general competitive and market positioning. Therefore, the corporate management team is pivotal in the attempt to improve the corporate image. The issue of corporate governance received much attention in the 1990s, following the financial crisis in East Asia and South America, as well as the series of corporate scandals in other developed countries like the United States (e.g., the collapse of Enron and WorldCom). Indeed, corporate governance seems to be increasingly vital for both developed and developing economies as a vehicle to sustain their business, economic growth, and development. As Iskander and Chamlou (2000) argue, corporate governance has become a critical consideration for both developed and developing nations in the globalization age, because of the growing need for nations to gain access to domestic and international financial resources. It has also acted as a key element with respect to enhancing the power of the private sector to contribute to economic and social progress.

1.1.1 Definition of Corporate Governance

In order to better comprehend the mechanisms of corporate governance and its related practices, it is important to be clear about its definition. In fact, it is difficult to find a tight definition of corporate governance, it being loosely described as a collection of structures and processes put in place for the purpose of controlling and directing activities pertaining to an organization (Ching et al, 2006). It is also described as the method through which firms are controlled and directed (Cadbury Committee, 1992). It could also entail the process of making decisions and then implementing them. In reality, corporate governance may bear diverse meanings for various real-world organizations (Abu-Tapanjeh, 2008).

Giapponi and Scheraga (2007, pp. 101) state that “Corporate governance is the set of institutional arrangements affecting corporate decision-making and deals with the relationship among various participants in determining the direction and performance of corporations”. Three dimensions of decision-making in a corporate environment form the basis of the model that needs to be implemented by an organization. The decision-making process in terms of corporate governance revolves around the questions of: (a) who makes the decisions, (b) For whom these decisions are potentially made for, and (c) the relevant resources to back that decision-making process.

1.1.1.1 Corporate Governance

Numerous studies suggest that corporate governance is an influential factor in banks' corporate risk and performance (Marcinkowska, 2012; de Larosiere et al., 2009; FSA, 2009). However, corporate governance is a broad and multidimensional concept that lacks a standard definition (du Plessis et al., 2010), and thus, it differs from one industry to another, and from one country to another (Solomon, 2007). This can make for difficulties in interpretation of what is good and what is bad corporate governance.

In the banking sector, corporate governance can be described as a system through which the performance of a bank is guided and supervised in order to realise the required objectives. Effective corporate governance reinforces transparency, accountability and credibility in order to protect shareholders, customers, employees and the public in general (CBK, 2005). According to the Basel Committee on Banking Supervision report (2010), *“corporate governance involves the allocation of authority and responsibilities, i.e. the manner in which the business and affairs of a bank are governed by its board and senior management.”* In this definition, effective corporate governance in the banking sector is marked by the presence of a board of directors that has experience and qualifications required for accomplishing responsibilities such as: developing strategic objectives and plans, establishing a corporate value system, setting an effective control system supported by independent and qualified internal audit, defining clear lines of accountability and responsibility, facilitating transparent management, and employing compensation systems that offer incentives for the attainment of banks' objectives (CBK 2005 ; FRC, 2012). Corporate governance also includes the role of the board and senior management in running the bank's everyday business, determining the bank's risk appetite, protecting the interests of depositors and stakeholders, and meeting the expectations of the shareholders (Basel Committee on Banking Supervision, 2010). This is in line with the definition provided by Walker (2009), who suggests that corporate governance focuses on protecting and advancing the interest of shareholders by determining the strategic direction of a bank and appointing a capable management and board to attain this.

In the literature two approaches to corporate governance systems can be found. The first is the bank-oriented approach, and the second is the market-oriented one. The characteristics of each are presented in Table 1.1.

Table 1.1: Bank Oriented Corporate Governance System vs. Market Oriented Corporate Governance System

Bank (firm) oriented corporate governance system	Market oriented corporate governance system
<ul style="list-style-type: none"> • typical for the European continent • focus on internal monitoring of the corporate activity (Internal System) • equity shares as the main tool for direct control • mutual property of the corporation • banks are not controlled by any other markets • relations with banks are long-term oriented • employees actively participate in the control of the corporation, • administrative authority has two-level construction • dominant owners are strategic investors • do not focus on maximization of the shareholder value • Huge probability of interest's conflict between the majority and minority shareholders. 	<ul style="list-style-type: none"> • typical for the Anglo-Saxon sphere • focus on shareholder value maximization • application of the external control of the corporate activity (Outsider System), • the main source of financing is capital market • control of corporations through indirect market tools • dominant owners are institutional rather than individual investors (pension funds, insurance companies), • administrative authority has one-level construction • focus on short-term bank financing • passive from ownership perspectives • Huge probability of interest's conflict between the shareholders and managers.

Source: Baran (2008, 413-416)

It is worth mentioning that the two different concepts of corporate governance (bank-oriented and market-oriented) encompass different problems related to potential conflicts of interest between shareholders and other stakeholders. In the continental system, managers and owners directly monitor the bank activities, while in the Anglo-Saxon system; there is a continuing threat of the hostile takeover. In the internal system the bank value is

usually estimated in a non-market way (owners' estimation) while in the external system the valuation is done on the basis of stock-market price. What is more, insider trading appears very rarely in the continental system, while in the Anglo-Saxon sphere the substantial frequency of the above behaviour calls for high-price regulations. The first system is characterised by a low level of stock market activity, while the second utilises a high number of marketable corporations and individual and institutional investors (Baran, 2008, 413-416).

1.1.2 Corporate Governance Model

A recognized corporate governance model in practice is the "Managed Corporation Model, which answers the question "by whom". This is the generally proposed model in respect of corporations with a large, diverse ownership (Pound, 1995). The managers of the corporations occupy the central position under this model. They are vested with the authority to formulate strategies and set the operational policies of the company. The responsibility for hiring the managers is entrusted to the board of directors, and the managers so appointed lead the directors as well as the shareholders. The additional responsibility of monitoring the performance of the appointed managers resides with the board. It is also the responsibility of the board to terminate the contract of the managers in cases of fraudulent or unsatisfactory performance. The shareholders, however, have a very limited role, especially in replacing the board, when the company is unable to meet their expectations in terms of performance. Thus, under the managed corporation model, the scope pertaining to corporate governance is rather limited when it comes to the extent of hiring the right managers and monitoring their performance.

In the "Socially Responsive Corporation Model", the question of "for whom" is answered. Based on this model, the shareholders' interest acquires prominence and is considered the foremost principle of corporate governance (OECD, 1999). The performance of the management thus needs to be measured against the yardstick of the concept of shareholder value. This is the particular model that is being implemented within the US, the UK, and several other Anglo-Saxon nations. It has also gained popularity in countries like Japan and many other European nations. As far as this model is concerned, firms that have a proper market directive for the purpose of enhancing returns (for capital that already exists) are considered a good opportunity for potential investment by the institutions (Lewis, 2003).

1.1.3 Accounting and Corporate Governance: The Main Link

The literature has identified a close association between accounting and corporate governance. The objective of accounting is to identify measures and communicate relevant and adequate information that will enable users to make meaningful business and investment decisions. Baydoun and Willet (2000) observed that, in the “managed corporation model”, accounting disclosure can often remain restricted or limited to the degree to which persons who control the resources need the disclosure. However, it is true that several corporate governance issues can be addressed by information drawn from the financial statements. This is because most such problems are normally focused on any agency that has a larger stake (of a financial nature) in the entity in question. This answers the final question of with what resources and to whom, the accountability is directed.

1.1.4 Characteristics of Banks and their Impact on Corporate Governance

Banks can be seen to possess two linked features which require them to be considered differently from other institutions as far as their corporate governance is concerned. The first is that banks are opaque compared to non-financial institutions. Evidence shows that there is high level of informational asymmetry within the banking industry, which is not the case with other sectors within the economy. In banks, there is a high possibility of having a hidden loan quality over a long period because of invisibility reasons. In addition, banks have a mechanism for altering the risk composition of their assets at a much higher pace than do companies of a non-financial nature. Another technique which they can employ to hide problems, is to extend loan facilities to customers who are defeated to service previous debts (Zeitun and Tian, 2007). In this respect, the difficulties in obtaining information with regard to banks’ behaviour and their on-going monitoring activities threaten the traditional mechanism of corporate governance.

The second characteristic of banks is that they are heavily regulated. This is mainly due to the critical part that banking institutions are required to play in economic development, the opacity of their activities and assets, and the readily-available source of revenue. For this reason, the government has laid down regulations governing banks. In some extreme cases, governments have their own banking institutions and many other firms, which are regulated. The regulation of the commercial bank industry is a practice emphasized by most countries around the world. The international standards set up by the IMF, BIS and World Bank has placed pressure on governments to ensure their heavy involvement in the banking sector. However, the government regulations introduced have been noted to distort bankers’ behaviour, and inhibit the implementation of a standard process of corporate governance.

1.2 Background Information

The recent emphasis on effective corporate governance has had a pronounced effect on the way in which corporations function. Firm behaviour, elicited in the black-box argument, stresses the fact that firms are quite similar to production counters in their extent. Therefore, the complete activities of the firm are directed towards maximizing profits. However, in the belief that the motivations for governance do not completely reside with mere production-related and pure economic factors, researchers have gone on to focus their attentions with respect to the behavioural elements related to firm performance in order to better explain the economic viewpoint that directs the visible behaviour of middle-level managers and upper-level directors (Bhasa, 2004).

In this regard, Coase's (1937) views highlighting the 'nature' of firms, stressed the characterization of the boundaries of the firm in light of authority and direction. This work has revolutionized the way in which researchers have come to perceive firm behaviour. The same views were also echoed by Alchian and Demsetz (1972), who basically viewed firms as multitudes of relations rooted in contractual dealings. Supervising the construction of the team as a whole can only be feasible when the firm is understood as a web of contractual obligations. Subsequently, with respect to the overall development of agent-theoretic models, and in light of the arguments of Jensen and Meckling (1976), the prime focus became cantered on the behaviour-induced motivations of personnel responsible for running corporations. The forerunner of this modern viewpoint can be seen in that expressed by Berle and Means (2009) who argued that when modern corporations expanded in terms of size and stature, the control of the firm and its ownership would become two different concepts.

Promoters who still prefer to operate their companies in an old-fashioned style now need professionals with specialized skills in order to run them more effectively. The observations of Berle and Mean (2009) pertaining to the division of ownership in terms of the control over the company, have induced a chain reaction of sorts, influencing future studies to give the behavioural elements higher weight age in understanding the theory of the firm (Bhasa, 2004).

The basic conceptual framework of the research into corporate governance emphasizes the relationship among the various internal stakeholders, like the owners, directors, and managers. Several factors help outline the structure along with the practices of any country's corporate governance policies. These factors include the legislative and regulatory framework to highlight the distinctive roles and responsibilities relating to the

stakeholders involved in implementing corporate governance within an organization. The *de facto* realities of the corporate environment prevailing in the country, and the articles of association corresponding to the legal dimensions of the environment, also dictate the structure of corporate governance.

1.3 Overview of the Corporate Governance Models

For the purpose of comprehending the concept of corporate governance in a better fashion, it is necessary to study its application to corporate entities. In this respect, it is essential to gain an overview of certain basic theoretical models that describe the corporate governance practices on a universal basis. According to Lashbrooke (1995), a key issue stemming from the division of control and ownership is the passivity or activity of the controlling shareholders. The outlook of the public on the way in which various corporations have changed their function has changed drastically because of the increased ownership by the institutional investors.

Rubach (1999) states that the “prior theories no longer adequately explain the motivation of institutions, and the empirical research in the area of institutional activism is inconclusive.” He identified stewardship theory, stakeholder theory and agency theory, as tools more reliant on evaluating the external environment with respect to the home country or internal company dynamics, adding that there is no articulation of the underlying ideological paradigms in these models; nevertheless, Western thought contributed to the essential ideas. The ideas rely on what is perceived and expected from the respective roles of individuals singularly, of the enterprise and state on a broader level, and the underpinning relationships pertaining to how these elements interact between one and another.

1.3.1 The Agency Model

With respect to the fundamentals of the agency model, Hawley and Williams (1996) state that, “in the finance view, the central problem in corporate governance is to construct rules and incentives (that is, implicit or explicit 'contracts') to effectively align the behaviour of managers (agents) with the desires of principals (owners)” (pp. 21). Thus, the agency model is based on the relational dynamics of stakeholders with the firm. The major assumption that dictates the agency theory is the ownership of the corporations being dispersed as seen with respect to the ‘modern’ corporations of the United States. One of many consequences of such a dispersed ownership assumption is the existence of a gap between the owners, representing the ‘principals’ of the firm, and the persons in charge of managing the daily affairs related to the company, known as the ‘agents’. Because of this gap,

governance issues arise when the principals who are interested in maximizing their investments start to monitor the agents. The agents, on the other hand, might have an inclination to work towards enhancing their personal wealth. Jensen and Meckling (1976) help further outline that link, since the relationship pertaining to rights of ownership and management in a corporation represents that of a typical agency; the resulting issues linked with separating the ownership from control are also mostly agency-based.

1.3.2 The Stewardship Model

Donaldson and Davis (1994) stated that under the stewardship model, “managers are good stewards of the corporations and diligently work to attain high levels of corporate profit and shareholders returns” (quoted in Aduda et al., 2013, pp.111). This model works by motivating the managers principally through achievement and responsibility needs. The model assumes that, given the need for the managers to work in a responsible and self-directed manner, organizations may relieve the managers from being subservient to boards that are dominated by what can be termed non-executive directors. This model disagrees with the proposition of the agency model that managers cannot be trusted to contribute to the maximization of the earnings for the owners. The advocates of the stewardship model are of the view that managers, being the respected stewards of the corporation, are understood to put in all their efforts in a diligent manner to achieve higher-level returns for the shareholders.

1.3.3 The Stakeholder Model

Clarkson (1994) outlined, with regard to the stakeholder model, that the firm is basically a structure where stakeholders operate in a much wider structure of the host society. The host society is the one that is providing the required market and legal infrastructural resources for the company to accomplish its many tasks. The company’s basic aim is to develop value or wealth in the form of profits for the stakeholders. It manages to do so by converting stakes into sellable services and products. Thus, the ultimate goal of the directors and managers is more in line with the maximization of the total wealth of the corporation (Blair, 1995). Under the stakeholder model, this ultimate goal can be achieved by enhancing the voice of the stakeholders and providing a sense of ownership as an incentive to the participants operating within the umbrella of the firm, that contribute towards achieving this aim. Individuals can contribute to the total wealth maximization by offering vital, specialized inputs represented by human capital specific to the firm. It is also necessary for these individuals to share similar interests as those of the external shareholders, who remain passive in conducting the operations of the firm (Blair (1995).

1.3.4 The Political Model

This particular model recognizes the actions of the government in favouring the views of various constituencies by allocating corporate power and benefits to these respective owners, managers and other stakeholders. The micro-level allocations of the benefits between the corporate stakeholders are largely influenced by the macro-level activities at the national level. The macro-level national activities are influenced by the interaction of the corporate sector. In the words of Hawley and Williams (1996), “[t]he political model of corporate governance has experienced an immense influence on corporate governance developments in the last five to seven years” (p. 26). The political form of governance was not favoured largely by the US researchers. However, the importance of the ‘political procedures’ identified by Jensen and Mekling (1979) was recognized by scholars like Berestein (1980).

1.4 Motivation for the Study and Contribution

1.4.1 Motivation

Corporate governance systems are known to be important from business and economic perspectives since they aim at improving the efficiency of the firm by controlling risks and averting fraudulent activities, which can affect the image of companies negatively. Literature suggests that corporate governance system can improve the financial strength and performance of the company, overall increasing its value. The analysis of literature suggests that corporate governance system for banks and other sectors varies greatly. Consequently, this research has been undertaken using the UK banking sector as case study since the last decade has witnessed the emergence of corporate governance in terms of banking and finance. The majority of the studies on the topic have focused on investigating the impact of corporate governance on US banking sector, the Nigerian banking sector, European Union banking sector and Middle East banking sector. In the UK context, studies have been conducted to understand the significance of corporate social responsibility on the banking sector but literature available is limited. Consequently, this thesis focuses on contributing to the literature available on corporate governance in UK banking sector (Haan & Vlahu, 2016). From UK banking perspective, it is essential to study the significance of corporate governance and its impact on improving the financial performance and value of the firm (Abdumavlonov, 2012). Banks are considered to be important banks for increasing the economic growth of the country and banking crises and financial fraud can significantly impact the entire economy. Consequently, corporate governance is considered to be an important and significant issue. In United Kingdom, the

corporate governance system has been under critical review after the Global Financial Crisis of 2008. Like other financial markets, the UK banking sector experienced economic recession, which in turn had a negative impact on its economic and political atmosphere. From this perspective, corporate governance in the UK banking context is important to understand how it changed to combat GFC crisis (Abdumavlonov, 2012). The UK banking sector has also been selected because research suggests that the reforms introduced to improve and strengthen UK banking sector were not strong and robust and therefore, their effectiveness and efficiency to avert financial fraud and risks. According to Leventis et.al (2013), in the year 2007 banks such as Royal Bank of Scotland, bank of Scotland and Lloyds' Banking Group had collapsed. However, these banks had bonus culture, which was met by public criticism and outcry. In the same year, Chief Executive (CEO) of RBS, Sir Fred Godwin was given £4190000 reward, whereas CEO of Bank of Scotland, Andy Hornby was provided with £1, 926,000 payments and the CEO of Lloyd's Banking Group, Eric Daniels, was given £2,884,000 payment. These payments given at the time of the banking crisis in UK questioned the level of corporate governance system applied in the UK sector. More importantly, it questioned its integrity and effectiveness to avert financial risks and fraudulent activities in the UK.

The research has also been undertaken because corporate governance in the banking sector is different as compared to other sectors. This is because banks serve as institutions that provide external finance to other sectors to improve economic conditions and increase employment opportunities. Banks are responsible for the allocation of finance and therefore, this gives them the power and authority to make influence on the corporate governance system of other firms (Avgouleas & Cullen, 2014). They serve as payment systems in United Kingdom and therefore, crisis in the banking sector can affect all sectors. It is therefore important that the corporate governance system of the banking industry is strong and robust to improve the overall economy of the country. Consequently, this study has been undertaken to review the corporate governance structure that prevails in the UK banking sector (Haan & Vlahu, 2016).

Corporate governance is strongly linked with governance performance and governance risk. Strong and robust corporate governance system is known to improve the overall performance of the banking institutes and can help them to increase their value. It can improve stability of the institute, which can ultimately increase the bank's profitability and overall value (Abdumavlonov, 2012, Bennett, R., & Kottasz, 2012). Corporate governance system can help in reducing financial risks and corporate fraud and therefore, this can benefit different stakeholders significantly. Consequently, this study has been undertaken to review the corporate governance system in UK banking sector and the models of corporate governance that have been adopted in different banks.

Previous research by Shen et al. (2006) pointed out that the banking institutions are the most critical when it comes to industrial expansion, capital allocation and corporate governance of firms. In a situation where financial bodies, and banks, implement systems that facilitate the efficient mobilization and allocation of funds, it subsequently lowers the capital cost, boosts the capital information, and, consequently, stimulates productive growth within the company. This implies that the functioning of the banking institutions can have a tremendous impact on the operations of a firm, along with the overall fate of a nation (Gugler, 1999). Given the critical role played by the banks, the governance practices in banking institutions assume a pivotal role. Where the bank managers have sound practices and a mechanism of corporate government, they are in a position to allocate capital efficiently, and exert the discipline of effective corporate governance practice, particularly among the funded firms. On the other hand, if the banking institutions have managers who act based on their own discretion and interest rather than following the debt holders and shareholders' interests, there is the likelihood of inefficiency in society savings allocation and the exertion of the required governance practices among the funded customers.

In respect to the banking crisis, the authorities have set up an extensive advertising practice that explains the enormous consequences that are associated with poor governance practices within banks. It can be seen that considering the various corporation corruption cases, and the requirements of an environment where corporations transact their businesses mainly using the facilities provided by e-commerce, the steps taken by the federal government were appropriate. The measures taken to improve the operation of the auditing profession are also apt, as the reliability of external auditors was also brought into question after the collapse of Enron when Arthur Anderson provided an unmodified auditor's report. In another case, Ernst and Young provided a clean auditor's report which was followed by the collapse of Lehmann Brothers. Moreover, to protect investors' money from corporate fraud, disclosure requirements were further elevated to allow investors the opportunity to fully analyse the economic impacts of their decisions.

The banking crisis seriously destabilized the economy, intensified poverty, and affected governments. Where bank insiders take advantage and use a bank's resources for their own personal benefit, it may lead to the bank's failure, thereby crippling corporate economic development and financing (Torna, 2010). Though the banks are important facilitators of economic development, this is not the sole motivation for undertaking an extensive analysis of the banks' corporate governance practices. Indeed, banks should also been seen as firms with competitors, boards of directors, debt holders, and shareholders, just like any other organization.

It is essential to understand the association between corporate governance and corporate performance, and the risk undertaken by banks during a period that has undergone a financial crisis. A large amount of literature and many empirical studies exist, but there is little evidence within these of an exploration of such association. Studies that exist pertaining to the topic tend to address the role and effect of corporate governance on performance and risk in a manner that focuses more on ownership and control of firms (Maher and Andersson, 1999). Hence, there is a knowledge gap in terms of which factors affect both performance and risk, and in what capacity. The identification of key variables and their relationships in this regard may be beneficial in future to avoid similar crises. Hence, the examination of the link between corporate governance and corporate performance, and bank risk during the financial crisis of 2008 will provide the necessary data to enlighten the overall understanding of the topic.

1.4.2 Contribution of this thesis

The present study will help add to the knowledge and existing literature in several ways. Firstly, it will help in the development of a support system for the role of corporate governance in banks. This will highlight the relevance of corporate governance to the banking sector, and facilitate a practical approach to its implementation. Arun and Turner (2003) argue that, in most economic reports, problems associated with the weak mechanisms and ineffective corporate governance practices of banks, such as Lehmann Brothers and Northern Rock, were the main causes of the global financial meltdown, along with the European debt. In this respect, this thesis will play a critical role in proposing changes that could enhance the stability within the financial sector. According to Zandi (2009), various reform options, with a high emphasis on the accountability, constitution, roles of the boards of directors, transparency and risk management activities, are important to avoid another, similar financial crisis.

Secondly, there are external and internal mechanisms that can be utilized to curb agency conflict within an organization, as explored by Datta et al. (2001). Indeed, some external mechanisms are critical in this respect. It is explained within the literature that investors, investment professionals, legislators, and capital markets help in streamlining the operations within an organization, thus limiting agency conflict (Aboody and Kaznik, 2000). In this respect, this thesis intends to add to the existing knowledge of the part played by internal and external mechanisms in preventing principal-agent conflict. This will be accomplished through the provision of empirical evidence and expounding other factors beyond those contained in the literature.

Thirdly, the study will seek to provide additional insight by looking at the special role of the banking sector in the economy. Mamoghli and Dhouibi (2009) have claimed that an extremely critical role is played by the banking sector within the context of the economy, for example, Barclays Bank was recently reported as being involved in the manipulation of the London Interbank Rate (LIBOR) - the rate at which the banks lend to each other - which caused severe problems for the entire economy. For this reason, the interest of stakeholders appears to be of more importance within the banking sector as opposed to other unrelated sectors.

The thesis takes a more holistic approach towards improvement in governance and its association with bank performance as well as reduction risk. It extends the scope of corporate governance and bank performance literature beyond previous studies by analysing a number of corporate governance variables based on corporate risk and performance. It also examines various variables and their effects on corporate risk and performance providing a richer understanding of the dynamics of corporate governance structures.

Lastly, the thesis will improve the general understanding pertaining to business models in the banking and other sectors through the provision of a well-grounded theoretical model in light of the role of corporate governance as part of the value creation process. Fiordelisi and Molyneux (2010) pointed out that a large amount of literature has focused mainly on empirical evidence when examining the performance and corporate governance practices. In contrast, this thesis will explore new methods of value creation through improved governance practices. It will employ knowledge-based resources combined with human and financial resources to improve the governance, information processing, financial management and risk management practices of banks. In this way, it will provide verifiable evidence and key insight in terms of corporate governance in enhancing the overall administrative capabilities of banks and other organizations.

1.4.3 Significance of Corporate Governance

The significance of corporate governance emerges from separating the ownership elements from the control side of running a corporation, and is associated with the conflicting interests in terms of principal (i.e. owners) and those of the agents (i.e. managers), commonly referred to as principal-agent problems (Jensen and Meckling, 1976). As a result, the principal needs to bear the agency costs related to monitoring and auditing costs, the extraction of private benefits by the agents and the residual losses due to the agent's poor investment or other corporate decisions. However, the related literature (e.g., Shleifer and Vishny, 1997; Barclay et al., 1993) goes on to suggest a further extension of the agency

theory by incorporating the conflicts arising between the governing party and the minority shareholders. These studies refer to the agency costs related to the governing shareholders' expropriation, something that often comes at the cost of the minority shareholders. This issue goes on to be an important aspect of the corporate governance system when applied to the UK banking industry, where the controlling shareholders, being integral to the management, may often seek to maximize their wealth, posing serious agency costs for the external shareholders as well as the firm.

The presence of corporate governance problems might have an influence on the firm's capital structure decisions, especially in relation to the firm's access to finance. Poor corporate governance may lead to constraining the firm's ability to raise external finance (La Porta et al., 1998) which in turn has a counter-productive effect on the development of the capital market from a national perspective. According to Crowther (2011), "in the absence of effective corporate governance, the objectives of long-term shareholder value, corporate democracy, transparency in operations and reporting and internationally acceptable standards of performance" will remain illusory in the corporate environment.

Another study conducted by Du and Dai (2005) examined the ratings for corporate governance in terms of markets that are considered as new or emerging markets, and developed markets. A positive correlation was found in terms of corporate governance of a healthy firm valuation and profitability. Habib (2004) argued that corporate governance in the banking sector plays a significant part in protecting the interests of the company's external stakeholders in any economy. Klapper and Love (2004) claimed that firms having superior governance quality are comparatively less likely to depend on a country's legal system to resolve corporate governance problems. As in any other economy, the UK banks have a significant role in contributing to the economic growth of the country. Corporate governance in UK banks serves to meet the objectives of devising and implementing strategies that properly consider stakeholder interests, and sustain the ability of a bank to remain a going concern, irrespective of the economic conditions throughout the business cycle. However, the 2007-2009 financial meltdown seems to have affected the banking system in the UK in such a way that the banks failed to meet these objectives. Despite the existence of several regulatory authorities, the control of the banking system and operations proved ineffective. The weaknesses in the US banking system affected the UK banks, possibly due to the contagion effect. For example, the sub-prime mortgage issue that affected the US banking system affected many banks operating in the UK. In any case, the poor performance of the banks in the UK during this time provides a strong justification for revisiting the corporate governance in the UK banking sector.

1.4.4 Risk Management

Moreover, most researchers chose this area because of the lack of investigations into corporate governance and its role in enhancing corporate performance and reducing corporate risk in the UK and, specifically, in the banking sector. Several risk areas affect the financial performance as well as the reputation of banking companies. These include: operational risks, business-related risks, financial risks, and event risks (Mamoghli and Dhouibi, 2009).

Specifically, the present study seeks to investigate the influence of corporate governance on capital and the liquidity risks of banks. Capital is one of the essential factors in banking operations, as every aspect of banking is either directly or indirectly influenced through its availability (Mamoghli and Dhouibi, 2009). The safety and soundness of a bank can be well protected if the bank has an adequate capital base. The financial performance of a bank depends on its lending capabilities, which in turn depend on the availability of adequate capital (Dionne, 2004). The objectives of corporate governance can be effectively met when the bank is able to perform well financially, and meet its commitments to the entire stakeholder base. As this is dependent upon efficient capital risk management, this research considers the impact of corporate governance on the capital risk of banks (Dionne, 2004).

Similarly, liquidity is an essential element to ensure the growth of a bank (Hall, 1999). In this respect, liquidity risk management becomes a cornerstone that translates into the confidence in the banking system. This is because banks are highly leveraged entities. A liquidity shortfall within a single institution will have an effect on other institutions, as well as on the financial system of the economy as a whole. This has been witnessed in the recent financial crisis, which is fundamentally a liquidity issue (Hall, 1999). The survival of a banking institution depends on its efficient liquidity management, as liquidity mismatches have an instant effect on normal banking operations. Banks with liquidity issues are certain to lose customer confidence, resulting in runs on them. A main aim of corporate governance is the protection of all shareholders' interests, and this protection can be ensured only when a bank can maintain adequate liquidity. Hence, this study investigates the effect of corporate governance on both bank capital and liquidity risks. However, in adopting this focus, the study does not consider the impact of corporate governance on other banking risks insignificant, as each of these risks has its own impact and ramifications with regard to the operations and performance of the banking sector.

1.5 The Study Scope

This study covers listed banking companies operating in the UK, and explores the impact of corporate governance on the performance and risk-mitigating capability of these banking institutions. Additionally it examines the recovery phase of the banking sector after the recent financial crisis. The data and information gathered for the study are obtained from a sample of bankers and brokers, and is quantitative in nature, being collected via a survey. There is a high possibility that the respondents to the questionnaire survey might consider recent events and the role of corporate governance in terms of the protection of the stakeholder interests, shareholder interests, and those of banks managers to be sensitive issues. Hence, there is a potential limitation which requires the results to be considered in this light.

1.6 Objectives of the Study

The study aims to add to the literature on corporate governance in the banking sector in the UK, specifically in respect of the performance of those institutions. According to agency theory, better corporate governance reduces agency costs and enhances investors' confidence in the firm's free cash flow (FCF) and growth prospects (Drobetz et al., 2004). This has a trickle-down effect in the form of reduction of the rate of return (ROR) that is anticipated by the investors, which then leads to lower costs of equity capital for the company. This eventually enhances both the firm's performance and value. Likewise, a subsequent reduction in agency costs tends to translate into enhanced operating and investment performance in the case of firms that are governed efficiently (Arun and Turner, 2003). Taking these relationships into consideration, the study investigates the impact of firm-level corporate governance in terms of two main fronts: a company's performance in the context of the financial, operational, and management of corporate risk-liquidity and capital risks.

Firm-level corporate governance is a complex part of the corporate strategy, which is simultaneously influenced by several factors, including the ownership pattern, shareholder rights, the liberty and responsibilities enjoyed by the board and the management, financial reporting and disclosure, and responsibilities to the stakeholders (OECD, 2010). The relational dependence pertaining to corporate governance and corporate performance measures will be tested using different methods, including econometric modelling and a questionnaire survey. In light of the above discussion, the primary goal of this research is to investigate and understand the overall influence of the topic at hand in terms of the

performance of firms and the reduction of corporate risk in the UK banking sector. The main objectives can be summarized as follows:

- i) To investigate the role of corporate governance in helping enhance a firm's performance.
- ii) To explore the role of corporate governance in reducing corporate risk.
- iii) To investigate the perceptions of different stakeholders in terms of the usefulness of the corporate governance mechanisms in enhancing performance and reducing corporate risk.

In the first case, the study will inspect the relationship regarding corporate governance, including: (1) the different facets that help create a board (i.e. its size, role duality, frequency of meetings, etc.); (2) the committee mechanisms (i.e. the audit committee, remuneration committee, nomination committee size, meetings, etc.); (3) the ownership structure (i.e. free float, block holders); and (4) corporate performance. In terms of the second case, the research will scrutinize the impact of different mechanisms pertaining to corporate governance, along with its subsequent impact on the level of corporate risk (whether capital risk or liquidity risk). The last objective, as shown above, will examine the perception of the key stakeholders in terms of the usefulness of corporate governance.

1.7 Research Questions

With regard to the above objectives, the study will address three main, closely related research questions, namely:

- i) What is the role of corporate governance in enhancing corporate performance?
- ii) What is the role of corporate governance in reducing corporate risk?
- iii) What is the perception of different stakeholders in terms of the usefulness of the corporate governance mechanisms in enhancing performance and reducing corporate risk?

Based on the above research questions, the first question relates to the firm's operational and financial performance and is aligned with the outcomes of the firm's performance. The second relates to corporate risk in terms of liquidity and capital, which are subject to poor

corporate governance. Both these questions will be answered by the data collected from the annual reports from UK banks which will be analysed statistically and subjected to econometric models (reported in Chapter Five). The last question will be answered by the data received from the emailed questionnaire survey conducted with bankers and brokers. Within the survey, the relationship between corporate governance and the performance is covered through 13 questions, while that between corporate governance and performance is covered by 15 questions. The results are analysed by statistical means and reported in Chapter Six.

1.8 Findings of the Research

The main findings of the research suggest that corporate governance system can enhance the bank performance and can reduce corporate risk significantly, which is consistent with the findings of previous researches conducted by several researchers. The findings of the research reveal that banks that have strong corporate governance system are considered to be financially stable and increase the overall value of the firm. The findings of the study also suggest that there is positive non-significant link between the board size and bank performance. The size of the board is considered to be the main component of the corporate governance system, which can affect corporate governance policies and frameworks significantly. Furthermore, board size can help in strengthening the corporate governance system and reduce the risks significantly. Corporate board size is also responsible for impacting the corporate performance, which is evident in this study and is consistent with previous studies. Although research suggests that board size large in nature effect corporate governance efficiency in negative manner, larger boards can significantly improve the decision making process and widen the discretionary power of the bank. The results of the study also indicate that the size and nature of the business affect the board size. However, banks need large board to ensure that the corporate governance system can be adopted efficiently to reduce corporate risk and fraudulent activities. The study also suggests that external directors' participation is integral part of the corporate governance system, which can improve corporate governance and monitoring system efficiently. External directors can increase credibility and the reputation of the banks. This study supports that there is a positive relationship between then existence of Remuneration Committee and Corporate Performance. This is supported by theories of the agency, stakeholder, and stewardship theories, which suggests that board committees are important function and components of the board.

1.9 Structure of the Thesis

The structure of the thesis reflects the logical flow of ideas and the standard organization of PhD theses. Accordingly, this thesis is organized into six chapters that comprise the main components of this research endeavour. Chapter One has introduced the research process by shedding light on the background to the study, the motivation for conducting it, its main aims, and the organization of the whole thesis. Chapter Two presents an extensive evaluation of the literature relevant to the subject in focus, highlighting the main findings of all relevant experimental studies. The aim of the chapter is two-fold: to introduce the main research terms, and to locate the present research topic within the wider field. A special focus is placed on 'corporate governance' as the main key term used in the study, especially in relation to the other relevant banking terms. Chapter Three describes some of the corporate governance theories that cover the underlying theoretical perspectives underpinning the study. More specifically, it presents the central corporate governance theories. This chapter provides the justification for the inclusion or exclusion of the theories discussed within to form the theoretical foundation of the research. Chapter Four presents the research methodology employed to accomplish the main research objectives. This chapter describes the research philosophy, design, and process. The study uses an econometric model and a quantitative survey with samples of bankers and brokers. This chapter includes a full description of the sample population and the development of the survey questionnaire. The data collection and analysis methods are also discussed in Chapter Four. Chapter Five presents an elaboration on the research results, especially regarding testing the hypotheses of the study and the research questions. The results are presented sequentially and illustrated in table form to support the argument. Chapter Six presents a discussion of the findings from the statistical analysis conducted on the primary data source. Finally, Chapter Seven concludes the thesis. It elaborates on the findings, and discusses the implications for management, the existing limitations, and makes recommendations for further study.

Chapter 2: Literature Review

2.1 Introduction

Corporate governance has become an important issue among policy-makers, over the course of the last twenty years, largely because of the growing role of the capital markets, the importance of corporate governance in maximizing the value and productivity of a firm, and the pressing need to create effective corporate governance systems for privatized firms, as evidenced by the global financial crisis of the last decade. Whilst good corporate governance is vital for all organizations, the problems faced by some enterprises are more serious and complex than in others, and as observed by Landsman (2006), this is the case in banks. Indeed, Zhou (2001) argued for a new conceptual framework for the corporate governance of banks, taking into account factors such as pervasive government regulation, complex information asymmetries, and highly-regulated markets. In the light of this framework, the corporate governance problems of banking institutions are discussed in the context of the complicated social environments, political environments, and economic environments. Specifically, the chapter reviews the different literatures and empirical studies related to the role of corporate governance in enhancing performance and reducing corporate risk in the banking sector. It begins by considering the global financial crisis as a means of setting the scene for the responding developments in the corporate governance of financial institutions. In this respect, the chapter focuses on the precise situations in both the United States and the United Kingdom, detailing especially the UK response to the crisis. It then discusses the business of banks – exactly what banks engage in - and the difference between corporate governance in banking institutions and non-financial entities. The dimensions of corporate governance are then reviewed, and this is followed by a discussion of corporate governance codes in the UK. Thereafter, the principle-based and rules-based approaches are considered, and the evolution of corporate governance in the UK follows. The relationship between corporate governance and firm performance is then discussed, using a number of variables as explanatory entities, i.e., the board of directors, board composition, non-executive and executive directorship, role duality, board size, board meeting frequency, ownership concentration, risk management, and other company characteristics. Finally, a more in-depth exploration of risk per se is presented, before a conclusion to the review is drawn.

2.2 The Global Financial Crisis

The global financial crisis was triggered when the French BNP Paribas bank banned the withdrawal of funds from three of its hedge funds, justifying the action on the grounds of

“complete evaporation of liquidity in certain market segments of the US securitisation market” (Norris, 2007). The significance of this action can be appreciated by reference to the fact that in 2012, the bank was ranked as the third largest in the world as measured by total assets (\$ million 2,542,738) (Fitch Solutions, 2012). That declaration on 9 August, 2007, created the start of the credit crisis of 2007 by causing a panic in the financial markets. Thereafter, on 12 September, 2007, the Northern Rock UK bank asked the Bank of England as a lender of last resort for liquidity support due to the bank’s inability to raise funds from the money market to replace other maturing money markets liabilities. The crisis subsequently officially developed in 2008, with the bankruptcy of Lehman Brothers Bank on 15 September, 2008, and the drop on the Dow Jones by 500 points on the very next day.

Not surprisingly, this major economic downturn, the first since the Great Depression of the 1930s, has been subject to vast analysis, from which it can be seen that the antecedents of the crisis can be traced back to the 1970s, when the US, UK and Western European financial markets were deregulated, leading to credit liberalization. This prompted investor to search for lucrative opportunities, and it was the property market which most appealed since it had shown the most positive upward trend over a long period prior to the crisis. Both investing parties (banks as lenders, and households as borrowers) anticipated high returns through engaging in the home mortgage and buy-to-let markets; and it is this real-estate bubble of 2006, accompanied by the deregulation of the financial markets which lie at the root of the financial crisis. These problems were detailed in the report released by the US Senate on 22 April, 2011 (US Senate, 2011), which identified four major causes: high risk lending, regulatory failures, inflated credit ratings, and investment bank abuses. According to this report’s findings, banks are among the major institutions being blamed.

The impact of the global financial crisis was heavier on advanced economies (37 countries) relative to emerging market and developing economies (152 countries), with most developed countries realizing a sharp downturn seen in Real GDP growth for the period 2007-2015 (see Appendix 1). Politicians, financial leaders, and the general public supported the findings of the US Senate Report that the banks were responsible for this crisis, and in its aftermath, banks around the world received the brunt of the blame. Specifically, they were accused of taking on too much risk to the detriment of customers and the countries they were supposed to serve (Jawadi, 2010; Liang et al., 2013). The overall perception was that the corporate governance of banks had been so relaxed in the years preceding the crisis that the protection of stakeholders had become a secondary issue, with the maximization of profits being the first (Adams, 2012; Kirkpatrick, 2008). Consequently, many governments worldwide have since adopted a wide range of measures in order to mitigate the effects of the crisis and avert possible future occurrences of the

same phenomenon (Stolz and Wedow, 2013), and a considerable number of these measures have been directed towards improving the corporate governance of banks (Liang et al., 2013).

In the UK setting, in response to the significant effects of the global financial crisis, the then Prime Minister Gordon Brown, commissioned Sir David Walker in 2009 to conduct a review of the corporate governance of banks to determine the problems encountered in this regard, and to recommend suggestions for improvement (Mullineux, 2011; Walker, 2009). The Walker Review (WR) identified, among other factors, the composition and functions of the board of directors, as a pitfall of corporate governance in UK banking, recommending changes in board composition to introduce a broader range of people from within and outside the banks they represent, and the need to pay closer attention to risk management, rather than having a single focus on revenue and profit generation (LeBlanc, 2010; Walker, 2009). Since this review, several studies have examined the role and impact of corporate governance in the banking sector (Adams and Mehran, 2012; Laeven and Levine, 2009; Liang et al., 2013; Pathan and Faff, 2013). This one adds to that developing literature.

Detailed studies have also been conducted of the causes of the 2007-2008 banking crisis, one being by Lord Jonathan Adair Turner, who was the chairman of the UK Financial Services Authority until its end on 1 April, 2013. The Turner Review (TR) was a comprehensive investigation analysing the underlying causes of this crisis, which it found was triggered partly by macro imbalances and extensive developments and innovations in the financial markets that had developed rapidly in the previous decades (FSA, 2009). Similarly, a study by de Larosiere et al. (2009) on behalf of the European Commission, established that the crisis resulted from a complex interaction of market failures, monetary imbalances, poor regulation, and weak supervision (de Larosiere et al, 2009). In the lead up to the crisis, there was a significant accumulation of financial innovation and leverage, which in turn led to escalating financial risks in the financial markets in the UK and the global economy.¹

Both the TR and the report by de Larosiere et al (2009) highlighted low interest rates and abundant liquidity as the initial trigger for the crisis. However, further exacerbation emerged as a result of the increased financial innovation, which enhanced the outcomes of rapid credit and liquidity expansion. Since the mid-1990s, the strong macroeconomic growth witnessed in the market had been creating the illusion that sustainable high growth rates were possible. Due to low interest and inflation rates, the volume of credit increased.

¹ The TR includes a timeline from 2006 to 2009 tracing the stages of the crisis (FSA, 2009).

However, the central banks, especially in the US, where the crisis emanated, did not realize the need to adopt a tight monetary policy, and rather than taking steps to cause increases in the prices of goods and services, they increased liquidity, thereby contributing to the rise of asset prices. Consequently, increased imbalances in the commodity market as well as in the global financial market followed (de Larosiere et al., 2009).

In respect of the TR's findings, it is apparent that the low interest rates in the US market precipitated a widespread housing bubble. Indeed, the sub-prime mortgage lending increased from \$180 billion in 2001 to \$625 billion in 2005, an equivalent of 61.8% per year. According to the TR, this bubble was enhanced by complex securitisation financing techniques, and insufficiently-regulated mortgage lending. Nevertheless, within the European market, unsustainable increases in house prices were also witnessed. As consumer credit and mortgages expanded due to low interest rates, personal savings in the US market fell rapidly from 7% in 1990 to almost 0% by 2006, leading in turn, to the accumulation of huge global imbalances. The credit expansion in the US was financed by massive capital inflows from China and Saudi Arabia. Both countries having pegged their currencies to the dollar, imported loose monetary policy from the US, hence enabling imbalances to build up (Batten and Szilagyi, 2011). The TR particularly noted that since China and other surplus countries were committed to managed or fixed exchange rates, their surplus savings were not invested in equity, income, and fixed assets, but in risk-free government guaranteed bonds, a strategy which depressed yields and encouraged many investors to look for higher returns from more risky assets. As a result, risk became undervalued, thus compelling the originators of investment products to develop more complex and innovative instruments to offer greater yields. This brought increases in leverage and more risky financial products (Jizi et.al, 2014). Many financial institutions embarked on very high leverage (on and off-balance sheet), thereby rendering themselves more susceptible to significant falls in asset values (de Larosiere et al., 2009, FSA, 2009).

In general, the TR established that the banking crisis was largely caused by inefficiencies in risk management. The events leading up to the crisis indicated massive failures in the assessment of risk by banks and other financial firms, and those responsible for their supervision and regulation. The risk was further aggravated by a lack of transparency (opacity) regarding bank asset risks (Batten and Szilagyi, 2011). Similarly, the report by de Larosiere et al. (2009) found that as far as corporate governance was concerned, many boards and senior management of banks and other financial firms were not effective in understanding or addressing the complexities associated with new high risk financial products, and hence, underestimated the risks they were undertaking. The report further shows that board members also failed to provide the much-needed oversight or control (Larosiere et al, 2009). It is important to note that both reports agree that problems in

corporate governance were responsible for the presence of severe risks and the resulting crisis. However, the two reports differ in the factor which they believe led to the problem.

It is important to note that even though the financial crisis was triggered in the UK and France, the biggest material impact on the banking sector was in the USA with the collapse of Lehman Brothers Holdings Inc, which caused a major global shockwave, as indicated by Ciro (2013). Prior to the crisis, the bank appeared to be extremely profitable and successful as it introduced innovative financial products and actively participated in the money markets, providing its clients with sophisticated financial solutions which in turn brought back significant profits. However, the inherent build-up of risks was not clear as asset prices increased due to low interest rates. Additionally, during the housing boom of 2003-2004, Lehman acquired several mortgage-lending firms, Aurora Loan Services, and BNC Mortgage being just two of these; and by 2006, the firm had securitized mortgages amounting to approximately \$146 billion, recording a net income of \$19.3 billion. The first quarter of 2007 saw significant cracks in the US housing markets as defaults on sub-prime mortgages increased. The management of the bank and other financial operators within it failed to foresee and accurately assess the risk it faced resulting in a drastic fall in Lehman stocks, eventually leading to the closure of its BNC unit. In 2008, the firm filed for bankruptcy under Chapter 11 of the US Bankruptcy Act. Lehman's bankruptcy rebounded in stock markets around the globe, causing the credit and debt markets to seize up (Ciro, 2013).

Erkens et.al (2012) studied the impact of corporate governance on financial institutions, which were subjected to financial crisis of 2007 to 2008. Their research was based on empirical investigation with dataset that consisted of 296 financial firms in 30 different companies, which were subjected to financial crisis of 2007 to 2008. The results of the study indicated that organizations with independent boards and higher institutional ownership had suffered from "worse stock returns" during the crisis. The study also revealed that as institutional ownership increased, risk taking increased before the crisis. During the crisis, board independence helped in raising equity during the crisis. When equity capital raisings increases, the firms were able to avert the negative outcomes of the crisis.

Aebi et.al (2012) conducted a study to investigate the relationship between risk management, corporate governance and bank performance at the times of crises. Their sample size consisted of 372 US Banks, which had been affected by the GFC 2008. Their study aimed at investigating the risk management related governance mechanisms. The study focused on determining the impact of chief risk officer on banks performance, the roles and duties of the chief risk officer and the reporting done by chief risk officer to the CEO or board of directors directly, can lead to better bank performance. The authors used

ROE to determine the bank performance. Variables used by the researchers for corporate governance included board size, board independence and CEO ownership. The results of the study indicated that when CRO reported to the board of directors, the banks performed better during the crisis as compared to those banks where CRO reported to the CEO. The results also suggested that the corporate governance variables did not have positive or negative impact on bank performance during the GFC 2008.

Peni and Vahamaa (2012) conducted the study to investigate the impact of corporate governance on banks performance during the GFC 2008. The sample size consisted of US banks, which traded publicly. Their study aimed at analysing the relationship between corporate governance mechanisms and higher profitability and stock market performance. The findings were mixed. The results of the study indicated that banks that had adopted strong corporate governance mechanisms had higher profitability during the crisis. However, corporate governance mechanisms if it is strong, it had negative impact on the “stock market valuations”. The results of the study also indicated that after the GFC 2008, the banks with strong corporate mechanisms had positive impact on stock returns.

Berger et.al (2016) conducted a research on the impact of corporate governance in relation to failures of banks during the crisis. The researchers investigated the significance of bank ownership models, management and the structures of compensation and its impact on bank failures. The results of the study indicated that failures were impacted by the type of ownership the bank had. The results of the study indicated that “high shareholdings of lower-level management and non-chief executive officer (non-CEO) higher-level management increase failure risk significantly” (Berger et.al, 2016). These studies show that corporate governance mechanism is believed to be an important aspect for banks, especially during the time of crisis.

2.2.1 Crisis in UK Banking

The imbalances in the global economy in the past decades had resulted from huge capital surpluses in emerging Asian economies, such as China and Saudi Arabia, and enormous deficits in Western countries, such as the US and other developed economies. These led to a decline in interest rates, and the consequent encouragement of risk-taking practices in search for greater yields. In the UK which had experienced a sustained period of economic growth, capital flow imbalances spilled over into the economy, prompting high-risk practices, thereby fuelling even more imbalances. The supervisory system designed to protect the public from systematic risks failed in its mandate (House of Commons Treasury Committee, 2009).

Many banks overlooked the fact that only higher risks could generate higher returns, consequently lending money on easier terms, and pushing asset prices higher as interest rates lowered. Besides lending to individuals and businesses, banks also began lending to one another (interbank lending) (House of Commons Treasury Committee, 2009). The TR also established that the demand for more yields due to low interest rates prompted a wave of financial innovation that focused on developing, packaging, trading, and distributing securitized trading instruments (FSA, 2009).

In spite of the warning signs presented by the collapse of the Lehman Brothers in 2008, banks continued to engage in risky lending of credit and capital in an attempt to realize greater returns. For example, during this period, Bradford and Bingley plc, one of the biggest banks in the UK, engaged in a risky strategy that involved rapid expansion through acquisitions, focusing on self-certification, buy-to-let, and 100% mortgages that eventually led to the bank's closure and the transferral of its business to Abbey on 29 September, 2008. The circumstances of its collapse were that it had entered into a deal with the US General Motor Acceptance Corporation (GMAC) and acquired a mixed loan portfolio of £650 million buy-to-let, self-certified and standard loans from GMAC. This deal resulted in a flurry of loan acquisitions such that by 2003 Bradford and Bingley had loan acquisitions worth £1.4 billion. Consequently, the bank became overly-exposed to the US buy-to-let market and also incurred problems with self-certification of mortgages. This in turn led to the collapse and nationalisation of the bank in 2009 following the bailout of GMAC in mid-2008 (House of Commons Treasury Committee, 2009).

Similar to Bradford and Bingley plc, the Northern Rock Bank also engaged in risky practices that later led to its nationalisation. Due to imbalances in capital flows and the resulting low interest rates, the Northern Rock bank succumbed to market pressure to increase its revenues, resulting in its adoption of a business strategy that involved heavy borrowing, using the borrowed funds to provide mortgages to clients, and then re-selling the mortgages in international capital markets. As the demand for securitized mortgages began to decline in the international money markets, the bank was unable to raise the money required to repay the loans it had taken to finance the mortgages. In 2007, the bank sought emergency financial support from the Bank of England in order to cover its losses in the money markets, and when this incident was brought to public attention by the media, many depositors lost faith in the bank and began to withdraw their funds. Consequently, the Northern Rock bank was nationalised by the government in 2008 (Hart and Tindal, 2009).

Using the Bradford and Bingley, and the Northern Rock bank as examples, it is evident that some of the policies and practices employed by banks in the UK played a major role in

contributing to the banking crisis, using their unconsidered strategies of credit expansion, extensive borrowing to finance credit, and lower dependency on customer deposits. Such strategies exposed them to significant risks (Altunbas et al., 2011). The TR found that in the run-up to the crisis, many banks in the UK (especially Bradford and Bingley plc, and the Northern Rock bank) focused on rapid expansion through extensive borrowing and lending, large scale securitization, and sell down of credit assets in the mortgage markets. This policy generated a wide range of credit problems especially in corporate and mortgage lending, thus leading to credit capacity constraints and economic slowdown (FSA, 2009).

The hazardous practices and policies adopted by banks during this period revealed significant failures in risk governance, supervision, and regulation on the part of banks' boards of directors, and financial regulatory bodies. In the case of the Northern Rock bank, the Financial Service Authority (FSA) had warned of the changing trends in the market, citing sharp asset growth rates, the systemic under-pricing of risks, and shifts in risks for financial instruments. The FSA had also cautioned the bank against its total reliance on wholesale market funding as this reliance made it susceptible to liquidity risks. However, according to Bruni and Llewellyn (2009), the UK's regulatory regime itself was not without blame as it had failed to establish either a bankruptcy regime or deposit protection scheme for the banks. Similarly, Northern Rock had also failed to establish a resolution regime that could be used to handle troubled banks (Bruni and Llewellyn, 2009). The failure of the regulatory authority to introduce supervisory systems designed to protect the public from systemic risks was documented by the House of Commons Treasury Committee (2009).

However, this failure to regulate was not entirely negligent, since another important contributing factor to poor governance, supervision, and regulation in the course of the crisis was the lack of transparency among banks (bank opacity). According to Spargoli (2012), this impaired the ability of regulators to discipline or regulate banks. Investors and other agents were unable to effectively assess the risk involved in the banks' asset portfolios due to lack of information or transparency from bank operators (D'Avino and Lucchetta, 2010).

Essentially, the TR accentuates the fact that poor corporate governance at both the market and firm level played a major role in prompting the banking crisis. At the market level, there were failures in regulation and regulatory oversight by bank regulators such as the Financial Services Authority (FSA), and at the firm level, there were failures in risk assessment and supervision of banks' boards of directors (FSA, 2009). In regard to firm-level corporate governance, the TR suggests that poor corporate governance enhanced corporate risks and impeded effective performance, and recommended changes in corporate governance and risk assessment in order to avoid any subsequent banking crisis (FSA, 2009). It is clear

from the TR that a genuine link between corporate governance and bank risk and performance exists, and that the lack of adequate corporate governance at the macro (market) level that characterized the markets during the global financial crisis, encouraged the loose policies on the micro level. The deregulation of the market paved the ground for all governance problems at the firm level.

Unlike the TR, the Walker Review (WR) did not focus on examining the contributing factors of the banking crisis in the UK, concentrating instead on how the corporate governance of banks influenced the way in which the crisis unfolded. However, confirmation of the critical deficiencies in financial regulation and prudential oversight before the crisis appeared in that review, it being noted that these were caused by governance failures within banks that contributed to excessive risk-taking practices that further exacerbated the crisis (Walker, 2009). Moreover, the review established that the pressures sustained by major banks were largely brought about by a combination of corporate governance-related factors such as over-reliance on inappropriate business models, inefficient management and control processes, and defective judgment and diligence before and during the crisis (Walker, 2009). As a result, the review strongly emphasized the need to improve corporate governance in the UK banking sector (Walker, 2009). In this respect, Walker highlighted major oversights in board composition, functions and governance of risk, recommending the implementation of proper induction, training and development of executive and non-executive directors in relevant business areas. Additionally, he illuminated the need for greater time commitment by non-executive directors, and for the establishment of a Risk Committee answerable to the Board of Directors and to advise the board on risk exposure and appropriate risk management strategies.

2.3 The Business of Banks

From the previous sections it is clear that banks play a crucial role in the global economy. Consequently, it is appropriate to consider at this point, the precise business in which banks engage. In this respect, it can be seen that banks have various functions, the main one being to attract savers and lend the money deposited by them to borrowers. Simple as this might seem, the business of banks is actually both critical and complex (Greenham et al., 2012), and according to Omankhanlen (2012), banks represent the cornerstone and the linchpin of the economy, with many economic activities hinging on their efficient operation. Indeed, the way they conduct their operations and the services provided influence the performance of the economy (Allen and Carletti, 2010).

Banks function as a result of their vision or core objectives, and these can be seen to vary from bank to bank, and even from branch to branch. For instance, there are banks whose sole function revolves around investments, whereas others direct their activities towards community development, corporates and businesses (Buckova, 2008). However, irrespective of these variations in vision, banks are in being to seek profit, and the term 'bank' is usually used to refer to a commercial enterprise.

When banks provide credit in the form of loans, they increase demand deposits, thus leading to an increase in money supply. Essentially, banks hold almost all deposits for individuals, businesses, and government, and through these deposits, they are able to issue credit and receive interest or invest in various portfolios in real estate or capital markets. As a result, they create money, and this ability is crucial to the economy, since without their provision of credit to producers or businesses that need to secure capital for their operations, economic activities would be stifled or become impossible, thereby inhibiting a country's economic growth (Roussakis, 1997; Buckova, 2008; Iannotta, 2006).

In addition to this primary function, banks engage in other transactions that are classed as secondary. Examples include the payment and transfer of funds (Roussakis, 1997), currency exchange, processing of payments (telegraphic transfers, internet banking etc.), issuing of banknotes, cheques and bank drafts and the safekeeping of documents in safety deposit boxes (Buckova, 2008).

The business of banks extends beyond the mobilization and allocation of financial resources to include capital markets. Banks' involvement in capital markets takes two main forms. Firstly, banks directly participate in the capital markets by issuing shares and bonds as a means of obtaining funds. And some of the securities issued are listed for trading on a regulated capital market (Matei and Geambasu, 2010). Secondly, banks act as investors in the capital markets, many of them investing by buying shares and bonds in order to hedge risks, diversify their portfolios, and make profit. Some banks prefer to invest in fixed income instruments with a lower degree of risk such as government bonds, whereas others prefer to invest in instruments with a high level of risk such as shares, swaps, and options. Furthermore, banks engage in the capital markets as market makers, engaging in the simultaneous purchase and sale of different assets with the aim of enhancing liquidity and making profit (Jizi et.al, 2014, Avogouleas & Cullen, 2014). In this case, they provide the market with a specific quantity of particular assets and they initiate reverse operations to correct different asymmetries that are likely to occur in the market. This subsequently averts market volatility (Matei and Geambasu, 2010). Additionally, Matei and Geambasu (2010)

note that the business of banks in the capital markets involves providing financial investment services and carrying out financial operations on behalf of their clients.

Although banks' operations in the capital markets help banks to diversify their portfolios, enhance their liquidity, spread risks, and make profit, the manner in which these operations are undertaken can adversely affect the economy. Risks in the capital market such as changes in interest rates, equity prices, and foreign exchange rates can result in significant losses, and in extreme cases, can negatively impact upon banks' abilities to allocate financial resources to key sectors of the economy (Andries 2009; Kaminsky and Reinhart, 1999; Matei and Geambasu, 2010). Kaminsky and Reinhart (1999), for example, found that in most cases, bank crises are preceded by the excessive exposure of banks in the real estate and stock market. And Bollard et al. (2011) note that due to the interconnections between banks and the rest of the economy, the effects of bank failure have the potential to spill over to the wider financial or economic systems, especially in cases where the credit intermediation process is disrupted, or when financial saving cannot be accessed or the transactional role of banks (through its payments and settlements systems) is undermined. The failure of banking systems might lead to a slowdown in business cycles as businesses become unable to access credit to facilitate their operations. In instances where relatively large banks with linkages to other banks are involved, the effect of bank crises can become contagious crossing national and regional borders (Bollard et al., 2011), as already highlighted in the previous section.

Sergeant (2001) argued that banks play a critical role in enhancing economic growth and development. Similarly, Mukherjee (2002) stated that the economic development of a country largely depends upon the availability of banking facilities. One major way in which banks enhance economic growth is via the provision of credit to small, medium, and large scale enterprises, thus enabling them to purchase the required raw materials or infrastructure, expand and hire more employees, and/or invest in various platforms. However, in the event that banks increase their credit interest rates or are not able to efficiently perform their growth-supporting role either due to policy implications, or poor corporate governance, the economy is likely to slow down, and the rate of unemployment increase (Mehta, 2000; Sergeant, 2001).

Banks' lending activities make them susceptible to *credit risks* which occur when borrowers become unable to meet their loan repayment obligation. Moreover, bank lending can contribute to *liquidity risk* in a case where the bank has to make unexpected payments due to non-performing loans. Maturity transformation brought about by the conversion of short-term deposits into long-term loans further heightens the liquidity risks of banks (Apatachioae, 2014). As a result of these risks, banks' ability to provide credit at reasonable

interest rates is compromised, resulting in a slowdown in business cycles as enterprises become unable to access credit to facilitate their operations, investments or expansion goals (Apatachioae, 2014; Bollard et al., 2011).

Andries (2009) has observed that, as financial intermediaries, banks can play a major role in contributing to financial crises as their activities in the financial markets, such as the granting of loans, significantly influence interest rates, the price of assets, and the level of uncertainty in the market. Likewise, many other studies have been conducted that have established the role played by banks in different forms of financial crisis.

In recent decades, the business of banks has become not only more complex and opaque, but has also been undermined by non-banks in the 'shadow-banking' sector, which operates in an unregulated and uninsured environment (Bopkin, 2013, Haan & Vlahu, 2016, Avogouleas & Cullen, 2014). This phenomenon has made the job of bank managers and supervisors even more complex, as there are greater numbers of activities to manage, control, and implement, all requiring increased knowledge and the use of sophisticated techniques, as for instance in the evaluation of risk in the case of risk management, and the calculation of credit ratings for capital requirements (Mehran et al., 2011).

The business of banks directly shapes the model of corporate governance adopted and its relevant performance measures. Hence, the nature of corporate governance is characterized differently, depending on the bank's systems and its degree of market orientation (Baran, 2008). In the continental approach, the board of directors is the main executive body, while the supervisory council has controlling obligations. The representation of banks, and employees is very strong (Jizi et.al, 2014). This continental corporate governance system is characterized by indirect presence in the political sphere. Managers directly monitor banking activities, the ownership of stocks is concentrated, with banks possessing big shares, and banking managers rarely owning banking stocks. In this approach the link between banks and industrial capital is rather weak, rendering the most important source of capital as bank credits. Only a very small number of European banks are publicly listed, a fact which promotes low-liquidity and low control of capital markets (Haan & Vlahu, 2016, Avogouleas & Cullen, 2014).

In contrast, the Anglo-Saxon market-oriented system of corporate governance is proliferated. In this system, the main executive body is composed of executive directors, while the controlling body is comprised of non-executive directors. There is weak representation of banks, and employee involvement is undesirable (and therefore, limited). Connections between banks and politicians are unwelcome but nonetheless, much in existence. Managers do not directly control the banking activities. In respect of the

proprietary structure, ownership of stocks is dispersed, and neither banks nor managers possess a substantial chunk of shares. The link between banks and capital industries is strong, and thus the issuance of shares is the main source of capital. This situation results in high-liquidity of the capital market, a large number of publicly-listed banks, and high control of the capital market over banks (Faleye & Krishnan, 2015).

It is these attributes of both corporate governance systems that directly precipitated the global banking crisis.

2.4 Differences between Corporate Governance in Banking Institutions and in Non-Financial Entities

Whilst there are differences in the model of corporate governance adopted in banks according to their market orientation, there are much greater variations in the shape of corporate governance in banking institutions and non-financial enterprises. Minton et al. (2010) note one of the most conspicuous differences as being the number of stakeholders which is much larger in banks than non-financial firms, and a second difference as being the fact that the business conducted by banks is characterized by greater complexity and opaqueness than in non-financial enterprises. In this respect, Levin (2004) notes that banks have a mechanism for quickly altering the composition of asset risks, which is not the case when it comes to non-financial firms. By doing so, they are able to extend loan facilities to customers who have previously defaulted in a bid to hide certain problems.

Morgan (2002) has argued that numerous parameters, such as the role of the board of directors, and the compensation set for executives, have greater importance in banks than in non-financial organizations. Furthermore, Morrison (2010) claims that banks have an excess of 90% debt, as compared to the 40% debt observed in non-financial organizations, a fact attributable to the higher number of stakeholders attached to financial corporations. Besides their shareholders, banks have stakeholders, who are largely debt-holders, depositors and subordinate debt holders. Macey and O'Hara (2003) also stated that deposit insurance authority plays an important role in supporting a bank's health since in insolvency cases, such insurance is essential to ensure no negative consequences accrue for the entire financial system. It is important to examine and regulate these externalities, particularly among larger institutions. Indeed, studies highlight the importance of the government role as a stakeholder in the banking sector. Laeven and Levine (2009) argue that irrespective of the multitude of stakeholders, the action of the board members should solely reflect the shareholders' views; however, this is subject to certain regulatory constraints. It should be noted that the interests of the shareholders could substantially

diverge from those of the stakeholders, particularly with regard to risk. Indeed, shareholders prefer both a short-term view and volatility. Mehran and Anjan (2011) refer to the corporate governance models, mentioning that shareholders might have limited incentives to reduce a firm's risk-taking position due to certain commitments. This occurs irrespective of personal interest. They further highlighted that advantage assumes a different role according to industry. Non-financial firms for example, regard advantage as an important source of funding, whereas in banking, advantage is recognized as a production factor. Alternatively, banks usually act such that the cheapest factors are deployed in the production function. Again, given that depositors have access to the government-funded safety net, they are less sensitive to bank risks than other investors are to the risks associated with their investments, and for this reason, make limited compensation demands on those investments.

Another difference is that banks face severe liquidity problems resulting in mismatch of their liabilities with the length of their assets, and hence, corporate governance and general risk control are often adjusted to accommodate the co-existence of equity, and banking credit cultures. Long-term risk ownership is linked to the structure of the board and independence of directors. The change of strategies in adopting regulations implies that a bank will bear additional risks and banking board rooms may be unable to cope with the rising complexities and financial burden of such change (The Walker Review Secretariat, 2009).

Corporate governance for banks is dictated by various laws and the Basel I, II, III accords, which regulate international banking and arbitrage opportunities for banks. Investment banks voluntarily take advantage of changes in regulation so as to manage their risks by using capital calculations. The central bank regulates balance activities as well as capital requirements (Markus, 2009). These essential differences in capital structure, regulation, and complexity and opacity of business precipitate the divergence in corporate governance between the banks and non-financial institutions (de Haan and Vlahu, 2013), such that while the banks are governed as indicated, the non-financial institutions are regulated via the Companies Act and other statutes.

The capital structure of financial institutions includes deposits from customers, which are subsequently dispersed via loans to other customers. Hence, liquidity is involved as a means of trade, unlike in the non-financial institutions (de Haan and Vlahu, 2013).

2.5 Dimensions of Corporate Governance

Clearly, in order to determine what model of corporate governance will best serve bank performance by eliminating risk, it is necessary to first review the various dimensions of corporate governance as these directly influence the application of various mechanisms, and thus influence the ability to manage risk effectively, and ultimately produce good performance.

In this respect, Fernando (2010) notes that the ownership structure of corporations significantly influences corporate strategies and the recruitment of the top management team, such that in corporations with a concentrated ownership structure, ownership/control is in the hands of a small number of parties, i.e. individuals, families, holding companies or institutions. In banks, there is an in-built conflict between the minority and majority shareholders, the former being discriminated against, with the possibility of increased agency costs (Barclay and Holderness, 1989). The latter are those investors who own more shares than the other individual investors, but whilst it is usually perceived that majority shareholders own more than 50% of company shares, this is not necessarily true. In fact, in very large corporations with millions of shareholders, even 5% ownership represents considerable power and may constitute the major shareholders where the remaining shares are significantly dispersed. Minority shareholders have less influence on the board of directors than large shareholders, despite the board being the only tool to monitor the shareholders. Additionally, large shareholders are usually very influential beyond the board, as they may have access to inside information, and can require the adoption of different corporate governance mechanisms to discipline top management if necessary (Desender, 2009).

However, higher shareholder concentration can result in excessive control and the limitation of executives' initiative (Burkart et al., 1997), and this can lead variously to performance improvement (Gorton and Schmid, 2000) or deterioration (Demsetz and Villalonga, 2001).

On the other hand the Anglo-Saxon system is characterized by dispersed ownership where key governance mechanisms are seen as corporate control, legal regulation, and contractual incentives. This model may cause tension between managers and dispersed shareholders, who have significantly less power than shareholders with concentrated ownership (Jensen and Meckling, 1976). Eisenhard (1989) also points out that dispersed shareholders prefer exit strategies to attempts to monitor management. A potential solution to this problem is managerial ownership.

Desender (2009), however, suggests that when managers hold relatively less important shareholder positions, the agency problem may be less severe. Additionally, he makes the point that the board of directors remains the main monitoring instrument.

Other attributes of bank-oriented corporate governance systems like a low number of institutional holdings and anti-takeover provisions are seen as having a potentially negative effect on long-term performance (Akhigbe and Madura, 1996; Larcker et al. 2007), although some researchers have found that anti-takeover provisions have a positive influence on operating performance (Beiner et al., 2006; Seppo et al., 2011). In this debate, Akhigbe and Madura (1996) consider that in companies with a high level of insider holdings and a low level of institutional holdings, the adoption of anti-takeover provisions has negative effects on long-term performance. And Agrawal and Knoeber (1996) established a negative effect on performance resulting from higher control of the company via takeovers. Accordingly, Larcker et al. (2007) found a negative association between anti-takeover provisions and performance. Nevertheless, other studies suggest that anti-takeover provisions have a positive influence on operating performance (Beiner et al., 2006; Seppo et al., 2011). Indeed, Bauer et al. (2004) found a positive relationship between operating performance and the quality of external corporate governance.

Larcker et al. (2007) favour external corporate governance as the presence of debt (which is more characteristic for bank-oriented systems) is negatively associated with operating performance. On the other hand, debt triggers higher monitoring by creditors who begin to function as a mechanism of corporate governance (Klock et al., 2005). This in itself is also very effective in reducing agency costs, thereby positively influencing company performance (McColgan, 2001). Whilst the concept of 'agency' is discussed in the following chapter, it is worth briefly mentioning at this point that costs involved with agency can be considerable, since when one party is contracted to undertake services on behalf of another, there is the in-built assumption that the managers involved will take decisions that are in the best interest of the owners or shareholders of the corporation (Jensen and Meckling, 1976, Psaros, 2008), but this does not always happen. Indeed, principal-agent conflict of interests often occurs, since managers possess internal knowledge to promote self-interest, thereby gaining advantage over the firm's owners (shareholders) who are absent from the day-to-day running of the firm. Such behaviour can place the firm and its shareholders at risk (Fernando, 2009; Gomez and Russell, 2005). Consequently, the principal incurs monitoring expenditures to ensure as far as possible that discrepancies between the agent's decisions and those decisions which would maximize the principal's revenues do not exist, or are at least kept to a minimum (Jensen and Meckling, 1976). Agency costs are thus a dimension of corporate governance to be considered, since they

influence board structures, firm performance, and risk-taking, and trigger the need for market regulation to protect stakeholders such as creditors, the public and other customers (Berger et.al, 2016, Faleye & Krishnan, 2015).

Tomar & Bino (2012) conducted a study in relation to corporate governance and bank performance in Jordanian banks. Their sample size consisted of 14 banks, which were listed in the Amman Stock Exchange Market. Their study focused on investigating the impact of corporate governance mechanism such as ownership structure, board size and composition of the board on the bank performance. The results of their study revealed that board composition and ownership structure had positive impact on the bank performance. Their findings also revealed that banks that had institutional majority ownership had efficient and effective performance. The results also revealed that the size of the board did not have impact on the performance of the bank.

Bopkins (2013) conducted a study to understand the impact of ownership structure and corporate governance on the bank efficiency, using the banking industry of Ghana as case study. The firms from 1999 to 2007 were analysed using panel data analysis with the application of accounting and efficiency measures. The results of the study indicated that foreign banks had better performance as compared to domestic banks. The study came to the conclusion that managerial ownership has negative impact on the bank's cost inefficiency. Banks that have inside ownership are known to have lesser profitability. The results suggest that governance with a large board size can help in improving the profitability of the banks but can decrease their cost efficiency. Bank size and capital adequacy ratio had been used as control variables, which can determine the bank efficiency in Ghana.

Leventis et.al (2013) conducted empirical investigation to determine whether the commercial banks, which are listed in US have high degree of strict and efficiency financial and reporting system since they have highly effective and efficient corporate governance structures. The results of their study demonstrated that the banks with strong corporate governance structure had efficient and effective financial reporting mechanisms and structures.

Al-Musali & Ismail (2012) conducted the study to investigate the impact of corporate governance mechanism on bank performance in Gulf Council Countries: Bahrain, Saudi Arabia, Qatar, United Arab Emirates, Kuwait and Sultanate of Oman. Corporate governance mechanisms variables included board size, the use independent directors and ownership structures. Bank performance related variables included bank internationality, bank's adoption of Islamic and Shariah principles and bank riskiness. The control variables used by the researchers included bank size and financial performance, which were measured by

total assets and return on equity. The results of the study indicated that bank performance was affected by the ownership structure, the use of independent directors and board size. The relationship between bank internationality and bank performance was insignificant. Adoption of Shariah and Islamic rules in banks had positive impact on bank performance.

Jizi et.al (2014) conducted a study to investigate the relationship between corporate governance and corporate social responsibility (CSR), using the banking industry as the case study. The sample consisted of US banks. Variables such as the frequency of board meetings, board size, audit committee attributes, and board independence were used to determine the CSR efficiency. The results of the study included that independent and large boards had stronger CSR mechanisms. CEO duality also had positive relationship with CSR mechanisms.

Morekwa Nyamongo & Temesgen, K. (2013) conducted a study to investigate the impact of corporate governance on banking performance of Kenyan banks. The researchers had used ROE and ROA. The independent variables included CEO duality, board size and independent directors. The results of the study demonstrated that board size impacted banking performance. The large board size had negative impact on performance. The results also showed that CEO duality did not have any impact on performance, whereas the existence of independent board directors was associated with enhanced and superior bank performance.

2.6 Corporate Governance Mechanisms as a Means of Controlling the Agency Problem

Corporate governance mechanisms comprise internal and external procedures and systems that are implemented to ensure that the management operates the organization for benefit of shareholders and stakeholders (Leventis et.al, 2013). Internal mechanisms originate from within the corporation, including for example, management, ownership structure, internal auditors, and the board of directors, while external mechanisms originate outside it (Bushman, 2014, Berger et.al, 2016, Faleye & Krishnan, 2015). They include government regulations (including corporate law), market control, capital markets, rating agencies and institutional investors among others (Naciri, 2013, Rezaee, 2008).

External corporate governance mechanisms have a significant effect on corporate risks and performance. Naciri (2013) provides an example of rating agencies as external corporate governance mechanisms which play an important role in influencing corporate risk. In the banking context, these agencies assess banks' credit risk or the risks involved in their asset

portfolios. The failure of such agencies to effectively assess the risks linked to corporations' activities can bring about adverse outcomes that may expose shareholders to major losses.

External mechanisms have also been noted as playing a crucial role in preventing shareholder conflict. Capital markets and institutional investors provide funds for companies, and hence, participate in monitoring the corporate governance practices in place to ensure the management's interests are aligned with theirs (Florackis and Ozkan, 2004; Demsetz and Villalonga, 2001). According to Bhagat et al. (2001), legislators also act as an external monitoring mechanism, providing guidance on corporate governance operations, especially among the publicly traded corporations. By doing so, they help with streamlining operations, thus reducing the friction between the principal and the agent, and implying that they themselves are external stakeholders with an important part to play in the activities of a company.

Internal corporate governance mechanisms also have a significant effect on corporate risks and performance. Naciri (2013) particularly notes that internal control mechanisms provide the shortest approach for a corporation to realise its objectives by establishing place an efficient internal control system that aids in preventing the loss of resources, ensuring reliable financial reporting and enhancing the corporation's performance (Naciri, 2013). For example, internal auditors provide consulting and assurance services to the corporation, especially in areas of risk management, financial reporting, and internal controls (Rezaee, 2008).

Datta et al. (2001) observe that agency conflict needs to be treated by using appropriate mechanisms, which in their view, are those that motivate executives and provide sufficient compensation to align their interests with those of shareholders. In this connection, Aboody and Kaznik (2000) argued that management compensation should be based on the value of the firm and its performance, since this approach helps to boost the value of equity performance. In reality, however, there is no empirical and academic consensus regarding the influence of different types of compensation and managerial decisions. The literature on principal-agent theory discussed in detail in Chapter Three, confirms that the use of cash compensation alone is inadequate to provide a sufficient incentive for lowering the level of agency conflict within an organization. Indeed, it is believed that restricted stock, as well as equity compensation, is the most efficient solution for curbing agency conflict because these two factors employ a common financial benefit in aligning whatever elements are beneficial for both parties, namely the managers and the shareholders.

Another internal mechanism is monitoring, which Erkens et al. (2012) observe can mitigate the efforts employed towards agency bonding by the management team. In their view, the

bonding costs include what managers take for themselves in order to reduce the conflict. In a real sense, they include the efforts made independently by managers at their own utility expense. Bonding is difficult to quantify or observe, but Kanatas and Weston (2004) suggest two measurement systems that can be used to approximate the bonding effort, advertising which makes a company more visible in the market, and ultimately attracts a greater level of scrutiny by regulators and investors. This results in lower agency costs as the regulators do their job. Bhasa (2004) notes in this regard that over-strict monitoring does, in fact, increase agency-principal tension as shareholders are better able to detect malpractices in the operations and financial management. However, Core et al. (2003) claimed that an efficient monitoring system is important in reducing the friction between the parties.

There exist conflicting views regarding factors that determine or influence the effectiveness of corporate governance mechanisms. On one hand, the managerial power view holds that the management of a corporation can significantly influence some of the characteristics of corporate governance mechanisms thus rendering them less effective. This view accentuates the need to distinguish the relationships between key characteristics of corporate governance mechanisms, and the performance and risk of corporations (Forbes and Hodgkinson, 2014). On the other hand, efficient market theory suggests that market forces may influence corporations to implement a mix of corporate governance mechanisms that may be substitutive or complementary to each other. This view assumes that markets are largely self-policing and can reduce the need for other alternative approaches to regulation, such as government regulation. In contrast to the management power view, this theory holds that market forces are strong enough to ensure that managers do not overstep the mandate assigned to them by shareholders (Odeken, 2015).

Some scholars claim that there is no evidence of the significant influence of corporate governance on company performance (Rediker and Seth, 1995) while others assert that both internal and external mechanisms of corporate governance play a critical role in this respect (Naciri, 2013). A summary of internal and external mechanisms and their believed influence on corporate performance and risk is presented in Table 2.1:

Table 2.1: Internal and External Mechanisms of Corporate Governance

Mechanism	Characteristic	Influence on corporate performance and risk
Internal Mechanisms		
CEO compensation contracts	compensation ties pay to performance (frequently include stock option plans)	<ul style="list-style-type: none"> • CEOs are “both effort- and risk-averse”; align the risk preferences of CEOs and shareholders; • CEO compensation contracts embrace company’s shares ownership and performance based remuneration. Both components (substitute to each other according to agency theory) are believed to reduce agency conflict through higher dispersion of ownership, the reliance of the salary level on realization shareholders’ goals (Meckling, 1976) and increasing monitoring (Fama and Jensen, 1983).
Outside Director Independence	directors who do not have a material relationship with the firm or its management	critical for vigilant monitoring, often required by law; assess management performance more objectively than executive directors; less focus on short-term financial performance targets and more interested in measures which enhance firms’ long-term sustainability
Outside Director Equity Ownership	independent (outside) directors own company’s shares	may create a conflict of interest, necessary for directors’ monitoring vigilance
TMT* Tournament	pay disparity between the CEO and TMT members; remuneration is based on rank rather than marginal product,	“inherently motivating”, positive influence on the firm’s performance
TMT Equity Ownership	The company’s shares owned by other members of the TMT	very positive impact, no less important to effective governance
Non-TMT Inside Director Equity Ownership	ex-CEOs, founders (present in Board) owns company’s shares	Ex-CEO may negatively influence the successor CEO’s ability to deliver performance that deviates from pre-succession performance. Founders typically hold substantial equity stakes and they may have “socioeconomic” goals beyond firm profitability
CEO Duality**	The CEO also holds the position of the chairman of the board	negatively influence company’s performance (CEO sets the agenda of board meetings, recommends the

Mechanism	Characteristic	Influence on corporate performance and risk
		recruitment of directors to the board); critical for firm success due to its unity of command
External Mechanisms		
External Blockholders	The existence of an investor holding a large block of the firm's shares	very positive, a primary control mechanism
Market for Corporate Control	threat of takeover	a fundamental mechanism of last resort in corporate governance

Source: Adopted from (Misangyi and Acharya, 2014)

*TMT is the top five highest-paid executives as listed in the companies' proxy statements (Henderson and Fredrickson, 2001)

** In the UK context, it is recommended that the roles of Board chairman and chief executive should not be exercised by the same individual (UK corporate governance code).

It is important to note that the mechanisms outlined in Table 2.1 have the potential for complementarity and substitution, but that, as claimed by Rediker and Seth (1995), their ultimate effectiveness depends upon their combination. Their argument is that internal elements like, "monitoring by boards of directors and mutual monitoring by managers" and the incentive effects of managers' compensation packages which include shares, substitute for one another, while externally the risk of hostile takeover and "monitoring by large outside shareholders" tend to replace each other. Misangyi and Acharya (2014), in their comparative case analysis of S&P 1500 companies, revealed that different combinations of internal and external corporate governance mechanisms influence the corporate performance and operational risk variously. They suggest that the alignment of the other internal directors (beyond CEO) with shareholders through performance remuneration significantly increases the effectiveness of the governance. So too, do the presence of outside directors and board share ownership. Regarding the external mechanisms, the relationship between blockholders, and the threat of a takeover along with CEO duality can stimulate companies' profitability. When it comes to the TMT tournament both its presence and absence can lead to high profits. In regard to the negative influence of different mechanisms on corporate performance, the study reveals that a combination of TMT ownership with a dual CEO and an independent board (with the absence of any other governance mechanisms) is quite toxic. In summary, the main finding is that at least one of the internal mechanisms and one of the external mechanisms are required for effective

governance. Misangyi and Acharya summarise the substitutability and complementarity of corporate governance mechanisms as shown in Table 2.2.

Table 2.2. Substitutability and Complementarity of Corporate Governance Mechanisms

Complements	Substitutes
<ul style="list-style-type: none"> • CEO compensation contracts* • Outside Director Independence/ Outside Director Equity Ownership • Blockholders - Market for Corporate • CEO compensations contracts/Outside Director Equity Ownership • CEO compensations contracts/Blockholders • CEO compensations contracts/MCC 	<ul style="list-style-type: none"> • TMT Tournament/TMT Equity Ownership • CEO compensation contracts

Source: Adopted from Misany and Acharya (2014)

*different components of CEO compensation contracts may be complements and substitutes for each other

The interaction between the internal and external corporate governance mechanism is what comprises corporations' corporate governance structure. Thus, it can be concluded that both internal and external mechanisms to assure appropriate managerial monitoring and mutual co-operation between shareholders and said management are required to form a suitable corporate governance framework.

2.7 Corporate Governance Codes in the UK

Millstein et al. (1998) note several attempts to shape corporate governance practices in the UK, each focusing on improving its predecessors and introducing new initiatives to cope with increased corporate sector activities, and the evolution of the country's capital market. The following section considers these.

2.7.1 The Principles-based and Rules-based Approaches

The principles-based, and rules-based approaches to corporate represent alternatives which are used in different countries according to preference. Hope and Thomas (2008) observe that the US legislation prescribing a rules-based approach has been very influential

throughout the developed and developing countries in their efforts to strengthen their corporate governance regulations. However, Gompers et al. (2003) note greater activity in respect of countries' monitoring and enforcement of corporate governance, and in countries such as the UK, Canada, Australia and Hong Kong, a principle-based methodology has been adopted.

The principles-based approach has the distinct advantage that it requires all the members of a community to adhere to minimum standards of practice, whereas the rules-based approach allows for members to meet only the minimum standards of practice prescribed by the rules, and this brings the disadvantage noted by Kaserer and Moldenhauer (2005), that as soon as the rules are enforced, the constituents are likely to invent ways of getting around them without actually breaking them. Nonetheless, it is true that the tough rules-based approach has brought considerable improvement in the standards of corporate reporting in the United States, and significantly reduced concerns about the possible collusion between managers, bankers and auditors, as happened in the case of Enron.

In contrast, the principles-based approach, as observed by Agoraki et al. (2009) does not establish specific rules and standards of practice, recognizing that corporate governance practices mature over time. Moreover, it recognizes that different stakeholders have different expectations, and develops a broad set of standards to cater for this. Clark (2007) suggests that a principles-based approach requires firms to maintain confidence in their actions, and that over time, such actions leverage companies to adopt higher standards of performance, as minimal compliance has the disadvantage of failing to impress the wider business and stakeholder community. Thus, he perceives the biggest difference between the two approaches as being the prescriptive nature of corporate governance practices in the rules-based philosophy, and less rigid demands of the principles-based paradigm since as argued by Mallin (2004), this incorporates the 'comply-or-explain' principle whereby organizations can deviate from their national codes, if they can explain why. In contrast, firms listed in the US risk incurring stringent penalties by the Securities and Exchange Commission (SEC), in cases where they are unable to comply with the rules prescribed by the Sarbanes-Oxley Act, 2002 (SOX).

Klapper and Love (2004) also observe variations among countries in their principles-based approaches to corporate governance, which emerge because nation-relevant facets such as concentration in ownership, the legal framework and the board system, largely influence the national corporate governance practices. Hence, some governance codes are more stringent than others.

2.7.2 Evolution of Corporate Governance in the UK

Peebles (2007) observes that in the UK, the basic ideas surrounding corporate governance evolved during the early 20th century, with significant development in the direction of governing corporations, and more companies listing their shares on the stock exchange. This led to greater dispersion of the shareholders, and the links between the shareholders and company managements becoming more remote. According to Turnbull (2009), the European Economic Commission, with the intention of regulating corporate affairs, issued the fifth draft directive in 1972. This proposed the appointment of a two-tier board to control corporate activities, a model then prevalent in Germany and Holland. However, UK businesses and policy-makers preferred the unitary board approach, which Tricker (2000) explained as providing for the appointment of a board comprised of executives and non-executives with responsibility for the daily management of the firm.

The UK's first response to the introduction of corporate governance was the formation of the Bullock Committee, which according to Sundaram and Inkpen (2004), favoured the continuance of the unitary board along with worker representation, but this model was also rejected by UK business. Subsequent corporate governance initiatives resulted in the appointment of the Cadbury Committee, and the formation of the Combined Code (Tricker, 2000), which brought fresh impetus to such governance. The Code emphasized adherence to corporate governance through reporting and recommending the formation of structures and processes based on its guidelines which were to 'comply or explain' to ensure proper governance (Tricker, 2000).

Hence, as noted by Singh and Davidson (2003), the governance model that suited the corporate environment of the UK was developed on a 'principles-based' platform, which sought to achieve the required standards by ensuring compliance and performance through stricter conformance to the prescribed transparency and reporting standards. Gregory (2009) observes that the new corporate governance model evolved as a result of follow-up reports compiled and presented by Hampel, Greenbury, Smith, Turnbull, and Higgs. These reports formed the basis for the evolution of a comprehensive reporting and operational framework, both for the boardroom and the management.

According to Pannier, the EU Commission Action Plan envisaged in its directive *Modernizing Company Law and Enhancing Corporate Governance of 2003*, had already provided for various adjustments to company legislation in the UK and many other EU Member States. However, Mitchell (2004) notes the very strong reform of corporate governance practices in the UK in response to the inadequate norms which had prevailed until that time. Specifically, the governance issues at Shell had forced it to ultimately write-

off large reserves after they had been overbooked, thereby being detrimental to stock market confidence, and underpinning the need for corporate governance reform and legislative support (Mallin, 2006). Moreover, Taylor (2006) reports on the drastic changes in the UK corporate governance climate following the business scandals in the US and Europe.

The UK government undertook serious reform measures to prevent the recurrence of the events at Shell, and protect investors' interests (Tricker, 2000). Indeed, the Cadbury (1995), Greenbury (1995), and Hampel (1998) reports led to a marked change in the disclosure format of corporate undertakings in the UK providing detailed information to the users of various reports (Sheridan et al., 2006).

Dionne (2004) observed that the Hampel Committee, formed in 1998, supplemented the recommendations of Cadbury and the Greenbury Committees by suggesting improvements to their recommendations. And it was resulting from the Hampel Report that the London Stock Exchange prepared a general code of good practice, entitled The Combined Code, to be followed by companies wanting to list their shares on the Stock Exchange. The Combined Code was made compulsory for all companies wanting to list 31st December 1998 (Turnbull, 2009), and although it carried no legal status, it could fine or refuse to list companies failing to satisfy the Code's provisions.

The Turnbull Committee report followed in 1999, the recommendations of which included:

- The evaluation of different risks faced by the firm regarding the responsibilities of the board of directors.
- Ensuring that effective safeguarding mechanisms and internal control systems are in place to prevent or reduce risk.
- Implementing internal controls that include a transparent annual assessment of risk.

The Enron scandal necessitated a revisiting of the adequacy of the existing corporate norms, which resulted in the publication of the Higgs Report and the 'Revised Combined Code'. Both initiatives reiterated and stressed the board's collective responsibility, and recommended the continuation of the existing UK unitary structure rather than a move to the French and German models. The Revised Combined Code advocated greater participation of the non-executives in the affairs of corporations (Tricker, 2000).

According to McCarthy and Puffer (2008), the regulation of corporate governance is not new, having for decades been part of company law, and seen as extremely important. Hence, one should not assume that it did not exist before the various codes were drawn up. Corporate governance's norms and rules underpin the success of many market economies. Flannery (2010) suggested that despite variations in the definitions of corporate governance among corporations, it still predominantly relates to the tools through which a business enterprise is run, and managerial liability for overall conduct and performance.

2.7.3 Introduction of Combined Codes of Corporate Governance

As indicated, the Combined Codes emerged through the reports following the Cadbury Committee's recommendations in 1992. Specifically, the Greenbury Report in 1995 addressed executive benefits and pay-structures, and the Hampel Report of 1998 reviewed and updated the Greenbury Report's codes, underpinning the Combined Code of 1998. Ongoing review and updating of the Combined Code occurred via the Higgs Report and Smith Report, both filed in 2003, being followed by the overall review of the Combined Code three years later. All these efforts aimed to enhance the system designed to protect the rights and final benefits of company stakeholders, and in 2007 structural improvements to the board and internal management were recommended in the Keay Report together with more generalized approaches deemed probable to enhance the corporate governance of listed Public Limited Companies.

According to the Combined Code (2006), there should be no role duality, i.e., the Chairperson and Managing Director were to be two different individuals with more clearly specified roles that did not overlap, and made for easier monitoring and control of their actions. Keay (2007) introduced the remuneration issue into the debate, emphasizing the need for transparency and formality of policies relating to directors' pay, and the need for a relevant committee including non-executive directors put in charge of setting the remuneration for directors individually, to avoid any bias. It was also required that the remuneration policy be reported within the final annual report, along with clarification of the corporation's business model. While this goes beyond the statutory requirements laid down by the Companies Act of 2006 with respect to the business review, it is supported by the Financial Reporting Council. And as claimed by Seidl and Sanderson (2007), the presentation of the firm's strategy with respect to the generation of future value will aid the report's readers to assess the disclosures made during the business review.

2.7.4 Flexibility in Corporate Governance Practices

It is suggested by Seidl and Sanderson (2007) that the Combined Code (2006) is highly detailed, lacks flexibility, and makes the Code applicable even to those companies that, for instance, do not have non-executive directors. Higgs (2003) further argued that since not every company perceives non-executive directors as important, there should be additional measures to rectify this belief. Moreover, while the code is already extremely detailed, from the investor's viewpoint, there is much room for improvement (e.g. a clear division of responsibility, board balance, and transparency). Most importantly though, since the Combined Code is not legally binding, it is difficult to strictly enforce, especially if a firm chooses not to comply, and non-compliance is not considered as a legal breach of contract (Financial Reporting Council, 2006).

However, the 'comply or explain' principle does grant certain flexibility (Clarke, 2007), and as noted by Kiel and Nicholson (2003), deviations can occur with respect to the size of the company, its ownership, and variations in capital market requirements in different countries. Moreover, Parjis (2005) observed that companies adhering to the 'comply-or-explain' principle are construed as conforming to the code as a whole, whilst having the option of deviating from individual rules. However, Anderson et al. (2004) argue that the flexibility could not be considered as a means to ignore rules because the original application of the 'comply-or-explain' principle does obligate UK companies to declare and provide a public explanation of any deviations from the Code. According to the Combined Code: "while it is expected that listed companies will comply with the Code's provisions *most of the time*, it is recognized that departure from the provisions of the code may be justified *in particular circumstances* Every company must review each provision carefully and give a considered explanation if it departs from the Code provisions" (Financial Reporting Council, 2006:5).

Solomon et al. (2000) suggested that the purpose of introducing flexibility in the Code is to increase its *responsiveness* to individual circumstances. This allows the Code's complexity to be kept to a minimum. Clearly, the regulators of the process must assess and support their own position by presenting authentic reasons for non-compliance. The code issuers cannot take responsibility for assessing the application pertaining to the relevant provisions *on behalf* of the companies whom it affects. Likewise they cannot evaluate the responses of the affected companies, which must themselves assess both the applicability and the appropriateness of their response. However, others who deal with such assessments must monitor and judge the authenticity of such assessments. Thus, the flexibility embodied in the 'comply-or-explain' principle leads to a situation in which the third parties have to monitor and enforce the conformance to the Code.

Seidl (2007) believed that individual shareholders become the third party that makes the assessment and undertakes the monitoring. The capital market is entrusted with two primary functions - evaluating possible deviations and enforcing the Code, which is in the direct interest of the capital market constituents. It is the job of the shareholders and other involved parties to better evaluate the company's financial statements (Financial Reporting Council, 2006:4).

The 'comply-or-explain' standard thus reduces complexity in the framing of the regulatory design, and allows a fair and reliable evaluation to be made by the particular constituents themselves, rather than involving a third party (Essen et.al, 2013).

2.7.5 Independence of the Directors and Corporate Governance

The independence of the directors is discussed under the Combined Code 2003 (Provision A.3.1), which prescribes the criteria required for company directors to be considered independent. Roe (2003) suggests that independence might be accorded even if directors fail to meet all of these criteria, provided a justification can be given by the company, and is accepted by the shareholders.

It is the board's responsibility to indicate in the annual report, which non-executive directors it believes to be independent. Such decisions must be reached after the board has considered all possible influences upon a director's judgement (Boone et al., 2007), and the reasoning in this respect must also be explained. Specifically, the board must consider whether a director:

“has been an employee of the company or group within the last five years; has, or has had within the last three years, a material business relationship with the company directly, or as a partner, shareholder, director or senior employee of a body that has such a relationship with the company; has received or receives additional remuneration from the company apart from a director's fee, participates in the company's share option or a performance-related pay scheme, or is a member of the company's pension scheme; has close family ties with any of the company's advisers, directors or senior employees; holds cross-directorships or has significant links with other directors through involvement in other companies or bodies; represents a significant shareholder; or has served on the board for more than nine years from the date of their first election” (Financial Reporting Council, 2012:11).

The Combined Code (2006) requires a high degree of independence to ensure the objective functioning of non-executive directors, without any interference from others. According to Milliron (2000), increased independence also reduces bias or favouritism in the work of non-

executive directors. Moreover, the Code provides the following conditions via Article A.31 to ensure their independence. He or she:

- Should not be a former employee of the firm within the last half decade, and particularly not have served as the company's Chief Executive.
- Should not have a current or former link with the firm within the last three years either through sitting on the Board of an affiliated company (a subsidiary or joint venture partner) or a company which provides business services (for example, consultancy advice) for a fee.
- Should not have served as a non-executive of the company for over nine years, a condition which has proved to be one of the most controversial.

The above provisions are additional to the conditions included in the earlier Code (2003), thus expanding the scope of director independence. Austin (2007) makes the point that the Code also specifies that a non-executive director should not hold any interest on behalf of a key shareholder, nor be found to have any family ties with respect to the company. Nonetheless, the Board may proclaim a non-executive director as an independent figure irrespective of the application of any of these circumstances, when it considers such an individual to function with independent judgment and character. The new Code has substantially dealt with this 'let-out' provision in providing exceptions to the conditions prescribed under A.3.1. A comparison of the earlier and the new Codes reveals improved coverage of the provisions relating to director independence. Hope and Thomas (2008) claimed that the earlier Code appears to contain some ambiguity regarding the establishment of listed companies' directors' independence. The exceptions to the provisions of A.3.1 relating to director independence are important from a corporate governance perspective, which has been dealt with extensively by the new Code, which while leaving the status of independence to be decided by the management, amply provides for quantitative measures to assess such independence. However, Cornett et al. (2007) argue that it is not entirely certain that non-executive directors can be independent as they are appointed by the executives and shareholders, after recommendations from those very executives. Furthermore, they are expected to be able to work effectively with the other directors so there is a requirement for them not to be opposed to on-going executive decisions.

Austin (2007) notes that the new Code includes a new supporting principle regarding the chairperson's responsibility to lead the board and promote a culture of openness and

debate. There is also a new requirement for non-executive directors to provide constructive help in the development of strategy proposals. Moreover, as a recent principle, it is expected of all directors, executive or non-executive, to donate adequate time and attention so as to uphold their expected duties successfully. Additionally, it sets selection guidelines for board members, emphasizing the need for diversity and gender balance.

It is argued by Hartzell and Starks (2003), that all companies subject to the new Code should have regular development reviews conducted by the chairperson with each director. In addition, performance-related payment, and increased risk management strategies are required to improve the firm's long-term benefits.

The UK Corporate Governance Code superseded the Combined Code in 2010, to cover corporate governance as applied to the listed companies within the country; and the Financial Reporting Council (FRC) was placed in charge of helping those UK-based companies in understanding the code. The key changes are summarized by Coyle (2011) who states these as being: the assignment of responsibility to the board for outlining the amount of risk it is prepared to undertake to achieve strategic objectives; placing more emphasis on the part played by the chairperson; enhancing the part played by the senior independent director (as defined under the Combined Code 2003 and revised under Combined Code 2006); the emphasis on diversity and gender (See also Barber, 2011); facilitating the external evaluations of the board at least every three years in respect of the FTSE 350 firms; deciding the year end selection of directors for FTSE 350 firms; providing further guidance on designing performance-related remuneration; and enhancing the disclosure of the business model and strategy in the annual report (Brain, 2010).

The difference between corporate governance in the financial and non-financial sectors was noted by Eatwell and Taylor (2000), who pointed to the higher risk associated with firms in the financial sector to the overall economy, and Ladipo and Nestor (2009) who observed that a bank which is not managed properly may cause a run on funds or an overall collapse, thus preventing it from discharging its responsibility towards other institutions in the same sector, and providing liquidity to non-financial sectors.

2.8 Corporate Governance and Firm Performance

Byrd and Hickman (1992) observe that good corporate governance can enhance firm performance, yet Chung et al. (2003) have argued that some studies report an inverse outcome. Indeed, according to Bathala and Rao (1995), there is an insignificant relationship between firm performance and the manner in which firms are governed. Such inconsistency

in conclusions on this issue are noted by Prevost et al. (2002) and other scholars who point to the limited information that can be gained by research tools like surveys that purport to make generalizations to an entire population from small samples, and also note the economic limitations to many of the studies reported. Hutchinson (2002) adds to the debate, observing that data obtained in many studies are superficial, unable to capture the complexities of corporate governance's impact on performance. Moreover, it is noted that the varying nature of performance measures is also a likely contributor to the inconsistency evident. Hence, it is advised to take multiple approaches to achieve greater accuracy in describing the reality.

As highlighted by Singh and Davidson (2003), a sound corporate governance policy would benefit management at all levels and prevent corruption. At the same time, it might enhance a firm's overall values, subsequently minimising investment-related and finance-related risks (Hossain et al., 2000). Indeed, Shen et al. (2006) point out that a solid corporate governance policy is a strong aid while making the decision to invest in a particular company.

2.8.1 The Impact of Governance Practices on Corporate Performance

Governance practice variations are observed in different companies, industries and countries, resulting from differences in regulatory, statutory and institutional settings, and the presence of past trends and culture-specific elements.

According to La Porta et al. (2002), research comparing the assessment of firm performance in twenty-seven developed nations revealed that firms are valued higher in countries that offer superior minority-shareholder protection. Parallel with this study, Klapper and Love (2004) argue that corporate governance has a higher level of importance in countries with a fragile frail statutory framework, and note a positive correlation between enhanced firm performance and subsequent value in the market. Fama and Jensen, (1983) earlier stressed the fact that corporate governance prevents managers or other executives from pursuing self-interests against the overall interests of the corporation.

Choi and Wang (2009) revealed that corporate governance is important not only in times of economic prosperity but also during times of economic lapses with respect to the economic environment or due to internal, firm-specific operational factors. Where a company is not properly governed, and there is an adverse economic environment, the ensuing actions of the firm could further lead to finance-specific distress further translating and adding to the woes of the external environment and economy. Moreover, taking the environment-specific debate further, it has been observed that the stock market heavily depends on corporate

governance during times of economic meltdown. Henning and Khan (2011), using the case of the East-Asian economic meltdown, were able to successfully back this claim by reporting a generally lowered stock price in the case of company stocks where management exhibited less direct ownership despite having increased controlling stakes (Lemmon and Lins, 2003; Healy and Serafeim, 2011).

2.8.1.1 The Board of Directors

Higgs (2003) observed that the effectiveness of the board influences corporate performance, either negatively or positively. Essentially, the board consists of a group of individuals elected to represent, and act on behalf of the shareholders of a corporation, thereby forming a central plank in corporate governance through their ability to say how that corporation is to be operated. In respect of banks in the UK, a unitary board is usual, which acts as the central repository of corporate power (Kershaw, 2012). Although the two-tier board model is an option provided under corporate law, most banks prefer the unitary approach because the two-tier structures do not seem to assure board members of access to timely and quality management information flow (FSA, 2009).

The key function of the board revolves around monitoring and supervising the management in order to ensure they behave in a manner that upholds the interests of the corporation and its stakeholders, since it is quite possible that the objectives of stakeholders and shareholders might be conflicting. As shareholders generally expect maximization of return from their investment, prefer volatility, and may have short-term perspectives, these expectations may clash with those of stakeholders who take a much wider perspective that goes beyond financial matters (as explained in Chapter Three). This conflict of shareholder and stakeholder expectations is addressed by various concepts, such as for example, Socially Responsible Investment, Corporate Sustainability and/or Corporate Social Responsibility (Erkens et.al, 2012, Dermine, 2013, Gali et.al, 2016).

At this point a short clarification of whose interests should be considered by UK boards of directors is required, and it should be noted in this respect, that in general, UK Company Law has been based on the concept of 'enlightened shareholder value' (ESV), which entails a focus on maximising shareholder value as the ultimate aim of companies. However the above approach does not exclude corporate social responsibility and its impact on the role of company directors. Accordingly, the main aim of maximising shareholder wealth cannot compromise the company's prospects of success, and must be connected with its risk management. The concept promotes 'sustainable' wealth creation, implying that short-term profit cannot undermine long-term value, and the interests of suppliers, customers and other stakeholders. Thus, the ESV concept assumes that shareholder interests are best

addressed if companies are responding to a wider group of issues rather than the narrow oriented pursuit of profit. This philosophy directly influences the duties imposed upon imposed on company directors, who are expected to act in good faith and in the best interests of the person that they represent, with appropriate care and use of expertise. Under UK Company Law directors are now required to consider: the possible long-term consequences of their decisions, the interests of the company's employees, suppliers, customers and stakeholders, the impact of the company's operations on the local community and the natural environment, the company's reputation and the need for fair play between various members of the company (ACCA, 2007).

This law also comments upon the method of appointment to the board of directors, indicating that new directors can be nominated by:

- resolution of the company's members through voting
- resolution of the directors
- resolution following direction from the Secretary of State

According to the UK Corporate Governance Code, the Nomination Committee should be comprised of independent non-executive directors since these are believed to better assess the skills and performance of candidates than internal directors. However, such independent directors should themselves be highly-skilled and capable of providing an impartial view of the board's considerations and decisions. Likewise, they should identify themselves strongly with the company's affairs. It is worth mentioning at this point that stakeholders may have an influence on the appointment of non-executive directors of UK banks by means of earlier banking regulations pertaining to nomination requirements and recommendations.

Boards of directors perform functions that are critical to banks' performance and their overall standing and competitive edge in the industry. Some of the key functions of the board include: guiding and reviewing corporate strategy, approving key action plans, business plans and annual budgets, and ensuring that they serve shareholder interests and are in line with the corporation's goals. The board also monitors the effectiveness of the governance practices exercised by management and makes recommendations for changes where necessary. Additionally, it oversees the selection or replacement of top management officials (House of Commons, Treasury Committee, 2010, OECD, 2004). It also oversees and enforces the disclosure of relevant information, and ensures the integrity of the bank's

accountability and financial reporting systems. In regard to this function, the board ensures that the necessary control systems that have been implemented for risk management and financial disclosure are aligned with relevant standards and laws. Additionally, the board manages and monitors potential conflicts of interest among the management and shareholders, and ensures that corporate assets or resources are not misused for personal interests. Agency theory argues that management cannot be completely trusted, and consequently, effective monitoring by the board is essential to protect the interest of shareholders (Jensen and Meckling, 1976; Psaros, 2008).

In general, the function of the board can be summarised as one that involves strategic leadership and safeguarding the interests of shareholders by providing a framework for effective and prudent controls which enables risks to be assessed and managed, and which facilitate improvements in performance (House of Commons, Treasury Committee, 2010, OECD, 2004). Since shareholders and creditors may be unable to impose effective governance in banks, the board plays a crucial role in ensuring the sound governance of banks. However, the extent to which the board promotes or protects the interests of different stakeholders (including shareholders) by monitoring and limiting the opportunistic behaviour of managers, depends on its composition, size, and structure, implicit in which is a consideration of the number of independent directors, executive directors, the level of board independence, and measures to ensure appropriate stakeholder representation (Pathan, 2009).

Clearly, these are variables that have a bearing on board effectiveness, and boards can be seen as weak without due attention to them.

2.8.1.2 Board Composition

Bohren and Odegard (2003) studied the link between board composition and good corporate governance (ultimately firm performance), arguing that greater director independence is better for the organization because a director with a close tie to the firm or its CEO might have difficulty in refusing a large and disproportionate pay, or may oppose or question the logic behind a potential merger. Indeed, some studies (e.g. Anderson et al., 2004) have found that firms perform better when they have a higher proportion of external to internal directors on the board. Haniffa and Hudaib (2006) for example, have shown when there are good numbers of external directors participating in board activities, companies achieve better stock returns and operating performance; and Dehaene et al. (2001) also found a significant and positive association in terms of the percentage of external directors and the ROE. Therefore the more external directors on the board, the

greater the chances for a company to improve its performance, an argument which finds support in the fact that the most fraudulent operations are instigated by insiders.

However, this requirement for independent directors, also called non-executive directors (NED), may in fact be a failing, since as noted by Johnson et al. (1996), these individuals are non-management members of the board, who may spend only a few days each year on their board duties, and regardless of their experience and knowledge, are likely to be worse informed about daily issues than executive managers who are much better placed to participate in board discussions. It is also necessary to mention that outside directors are not necessarily independent directors since even if they are not engaged in a company's daily activities; they may have relations with the firm through family or business ties (Pang, 2004).

A report by the House of Commons, Treasury Committee (2010) suggests that bank failures can be largely attributed to the lack of competency on the part of the board of directors. This is mainly because the board approves business strategies or products that may lead equally to bank failure as well as to bank success. Following the banking crisis in the UK, the TR established that major oversights by non-executive directors may well have exacerbated or at least contributed to the crisis. According to the TR, the analysis of the banking crisis revealed that skill levels and time commitment of non-executive directors were insufficient for them to appreciate the complexities of the risks in which bank managers engaged while pursuing aggressive growth strategies. Specifically, the Review questioned the capability of non-executive directors to perform risk committee functions. Hence, the lack of adequate technical skills to evaluate risks, and the inability to devote more time to board matters by non-executive directors, was perceived as responsible for significant governance, supervision and regulation failures that facilitated managers' engagement in risky lending of credit and capital in an attempt to gain more returns. In light of these findings, the review recommended the need for improvements in time commitment, and skill level of non-executive directors (FSA, 2009).

There is clearly, a lack of consensus in the findings by researchers to demonstrate that the composition or structure of the board would automatically lead to improved firm performance. Certainly, no spectacular association entailing board membership and firm performance in terms of profit or firm value has been reported by earlier studies. In fact, Eisenberg et al. (1998) reported no relationship at all between these two variables.

Of course, there can be no optimal board composition for all organizations, as different business environments require different skills and knowledge from board members, but the

literature is clear in discussing board composition in terms of insider and outsider directors, now discussed in more detail.

2.8.1.3 Non-Executive Directors and Executive Directors

Non-executive directors (NED) are basically members of the board who do not work for the corporation and are not involved in its daily operations. Several factors can influence their effectiveness in their monitoring and supervision role, such as: skill level, expertise, personal qualities, and time availability. According to the House of Lords, Select Committee on Economic Affairs, a high level of knowledge and experience in public affairs, banks' business, and other relevant fields are important in ensuring NEDs' effectiveness in monitoring and supervising managers. Moreover, personal qualities such as inquisitiveness, good communication and relational skills may enable them to effectively obtain clear and comprehensive answers from the management (House of Lords, Select Committee on Economic Affairs, 2009).

Under the leadership of the chairman, the role of NED involves executing proper oversight of management, referred to in the Combined Code, as scrutinizing and monitoring management performance. They are also expected to evaluate the integrity and effectiveness of financial information, financial controls, and systems of risk management. Additionally, NEDs are responsible for determining the appropriate levels of remuneration of executive directors and appointing and replacing directors as they deem suitable (Walker, 2009). Besides monitoring, supervising, regulating and controlling the management of the firm, NEDs are to some extent expected to be involved in its management. The WR points out that NEDs' experience and capabilities can enable them to influence corporate performance by monitoring and evaluating the performance of the board in relation to the set goals and objectives. Consequently, this may keep managers alert to such appraisal, and motivate them take measures that will improve performance. NEDs can also influence corporate risks by ascertaining and assessing the integrity of financial information provided by the management (Walker, 2009). This is likely to reduce information asymmetries or bank opacity, thus leading to effective checks and balances of management actions (Batten and Szilagyi, 2011). The Walker Report (2009) also recommends a time commitment of a minimum of 30 to 36 days a year for some of the non-executive directors, at least.

Despite the fact that, under company legislation, both the executive and NEDs have similar monitoring obligations or duties, the role of NEDs is often considered to be the more critical as far as monitoring, supervising and regulating the activities of corporations are concerned. Dignam and Hicks (2011) suggest that this is mainly due to the fact that their non-involvement in the running of the corporation is expected to bring some level of

independence and objectivity. Thomsen and Conyon (2012) argue that if a majority of board members have executive rights, i.e. they are executive directors, they are likely to accept all the proposals that they put forward. As compared to executive directors, NEDs are more likely to provide more critical and unbiased judgment that can help a firm improve its performance and mitigate risks. Non-executive directors particularly play a critical role in risk assessment and monitoring (Wearing and Li, 2010). Therefore, for effective monitoring purposes, it is recommended that firms should increase the number of NEDs in order to enhance board independence. Independence of outside directors is fully achieved only if their salary is fully independent of the company's performance, and they do not have any other (material or financial) relations with the firm. The UK Code of Conduct clearly states, that an independent director:

- should not have been an employee of the company or group within the last five years;
- should not have had any material business relationship with the company within the last three years (including extra salary from the company apart from a director's fee or membership in any of the company's pension scheme);
- should not have any family connections with any of the company's consultant or top managers
- should not hold any cross-directorships which could link him/her with other company's directors
- should not represent a significant shareholder;
- should not have been a member of the board for more than nine years from the date of their first election.

Independent directors are central to the effective resolution of agency problems between managers and shareholders (Fama and Jensen, 1983), since the need to protect their reputation as effective, independent professionals, provides them with more incentives than inside directors to monitor management (Hermalin and Weisbach, 1988). At this point it is worth noticing that according to Walker (2009), less emphasis can be placed on the independence of NEDs if the candidate has relevant financial industry experience.

Higgs (2003) recommends that the balance of executive and non-executive directors should be such that no individual or small group of individuals can dominate the board's decision-

taking. The UK Corporate Governance Code (2012) strongly emphasizes the role of independent directors in the Board. It recommends including them in all main board sub-committees (audit, remuneration, and nomination) and suggests that at least half the board, should be composed of independent NEDs, except in smaller companies, which should have at least two outside directors appointed to their boards. The Code very clearly indicates that NEDs are accountable to stakeholders (with special focus on shareholders) and are expected to maintain close relationships with them. Fulfilment of their obligations is supposed to occur through their attendance at Annual General Meetings, and participation in regular meetings of management with a range of major shareholders and other investors (nomination of NEDs should be presented to major investors).

It is worthy of mention that amendments to the UK Corporate Governance Code proposed in 2003, opposed the use of options, incentive plans or pension schemes in NED remuneration. The implementation of an option plan was thought to bring about an undesirable focus on share price rather than in underlying company performance. Similarly, participation by NEDs in incentive or pension schemes was felt to be undesirable. However, if exceptionally, some incentive payment were to be made, then not only would it require shareholder approval, but also any shares acquired by the exercise of the options would have to be held until one year after the NED leaves the board (Higgs, 2003). This rule should encourage companies to seek other reward solutions for NEDs rather than the common option plan. Generally, NEDs are remunerated with a competitive salary in recompense for the duties and the time commitment. The salary is usually benchmarked against the fees in an appropriate external comparator group, and is approved by shareholders.

The common practice in the UK is for the chairman of the board to be a non-executive director, and hence, not to interfere in day-to-day company matters. Thus, the NED chairman's duties are typically limited to matters directly related to the board, such as scheduling and chairing the meetings of the board or monitoring the performance of the CEO and the other board members. This solution is believed to improve corporate governance, on the basis of the role and advantages of NEDs presented earlier. However, it should be observed that Walker (2009) recommended that the bigger banks appoint their chairman from their executive directors. This suggestion is based on his other recommendation that the chairman of a major bank is expected to commit a substantial proportion of his or her time - "probably around two-thirds" - to the business of the entity.

A common advantage of insider directors is their increased familiarity with the company's manner of doing business (Bianco and Casavola, 1999). However, external directors can ensure that the competitive nature within the firm can translate into better returns for the

shareholder groups (Fama, 1980). Actually, it is essential for companies to have a mix of the two to improve its ability to perform better. However, expansion efforts based on political causes can offset the proportionality of external members on the board, which consequently leads to an adversely performing company. Moreover, as noted by Goyal and Park (2002), directors are often very short of time, and it is necessary for them to juggle their commitments to devote sufficient attention to board meetings if those meetings are to be effective (Guerra et al., 2009).

Typically, the board of directors in UK banks comprises the chairman, executive and non-executive directors. Table 2.3 presents a summary of their responsibilities.

Table 2.3: Summary of Responsibilities of Board Members

	Chairman	Executive Directors	Non-Executive Directors
Definition	<ul style="list-style-type: none"> • Chairs the Board 	<ul style="list-style-type: none"> • senior managers of a company, deeply engaged in firm's daily activities • Should not be allowed to take more than one non-executive directorship in a FTSE 100 company nor the chairmanship of such a company 	<ul style="list-style-type: none"> • usually does not engage in the company's management on a daily basis • often is independent of the company
Responsibilities in Board	<ul style="list-style-type: none"> • leadership • ensuring Board effectiveness • setting the board's agenda • ensuring allocation of sufficient time for discussing all issues • promote a culture of openness and debate • encourage effective contribution of non-executive directors • ensure that the directors receive accurate, timely and clear information • ensure and provide effective communication with shareholders 	<ul style="list-style-type: none"> • set the company's strategic goals • allocate necessary financial and human resources to fulfil strategic objectives • review management performance; • present a fair, balanced and understandable assessment of financial and business performance to price-sensitive public stakeholders and regulators • determine the nature and extent of the significant risks connected with achieving company's strategic objectives • conduct a review of the effectiveness of the company's risk management and internal control systems • report crucial findings from any control to shareholders 	<ul style="list-style-type: none"> • constructively participate in the development of proposals on strategy; • monitor the management and executive performance; • set up appropriate levels of executive remuneration • play active role in appointing and removing executive directors, • participate in succession planning; • should be available to shareholders if they have any concerns • evaluate chairman's performance, taking into account the views of executive directors

	Chairman	Executive Directors	Non-Executive Directors
Rights	<ul style="list-style-type: none"> • conduct meetings with the non-executive directors without the presence of executives 	<ul style="list-style-type: none"> • receive accurate, timely and clear information 	<ul style="list-style-type: none"> • talk to chairman without a presence of executive directors • serve as an intermediary for the other directors • include their concerns about running the company to board minutes • access to independent professional advice (at the company's expense) • attend scheduled meetings with major shareholders • receive accurate, timely and clear information

Source: UK Corporate Governance Code (2012)

A report by the House of Commons, Treasury Committee (2010) suggested that a board should incorporate a balance between executive and non-executive directors so that no party dominates decision-making. Many banks have an equal number of executive and non-executive directors in order to facilitate the soundness in decisions made (House of Commons, Treasury Committee, 2010). According to the UK Code of Corporate Governance (2012), all directors should be submitted for re-election on a regular basis (usually yearly intervals), subject to continued satisfactory performance. Moreover, the Code also recommends that on appointment, the chairman him/herself should meet the criteria associated with independent director.

In respect of executive directors, these individuals occupy full-time management positions in the corporation and are involved in its day-to-day running, receiving incentives in the form of salaries or bonuses (Naciri, 2013). In some instances, they perform dual roles by also chairing the board (Elsayed, 2007), a subject which is discussed in the next section. Generally, the roles of the executive and the non-executive directors are similar, but in most cases, the role of the executive directors is concerned with facilitating information disclosure

and providing relevant information regarding key plans of action, business plans, and annual budgets (Kershaw, 2012; OECD, 2004). As the managerial wing of the board, executive directors act as the go-between in respect of the development and execution of strategy. They provide information to the board, thus facilitating the decision-making process, especially when it comes to issues such as approving budgets or investments (Kershaw, 2012).

2.8.1.4 Role Duality

CEO role duality, the practice of the CEO acting as both the CEO of a corporation and the chairman of the board is an issue that has been discussed and debated by many scholars for decades (Krause et al., 2014; Dalton et al, 2007). A critical look at the literature, reveals mixed and conflicting perspectives on whether CEO duality is valuable or detrimental to a corporation (Elsayed, 2007; Kim and Buchanan, 2008). Many theoretical arguments against the practice of CEO duality have highlighted the issue of power concentration in one individual such that that person is able to dominate the board. This may reduce the effectiveness of the board when it comes to monitoring and supervising the management (Brockmann et al., 2004; Daily and Dalton, 1997; Alexander and Dhumale, 2001). Certainly the phenomenon of role duality has a large influence on the corporate insider power, since it enables the CEO when in the chairperson position, to dictate and disclose information to the other board members and, therefore, impedes the effective monitoring of the firm's activities. In addition, in many companies where fraud has been committed, the presence of role duality has been observed. In full recognition of this problem, some countries expressly forbid the CEO from taking up the post of the board's chairman, as indicated by Judge et al. (2003), who examine the relationship between board structure and corporate performance in the context of Russia, finding a negative link between firm performance and informal CEO duality. This finding was important because of the Russian Federal Law of 1996 which clearly forbids the CEO from doing this. Indeed, in the UK, the Cadbury Committee ruled the same way.

In order to effectively understand the argument about CEO duality, it is perhaps crucial to examine the role of the CEO and the chairman of the board. According to the WR, the CEO's role involves leading the executive board team towards making strategic proposals presented to the board, and overseeing the execution of the proposed strategy after it receives board approval (Walker, 2009). In this review Walker argues that under the leadership of the CEO, the executive plays a critical role in influencing long-term corporate success. As a result, he recommends the need for an executive team that is not dominated by a single voice where there can be room for open debate or challenge (Walker, 2009).

Moreover, the role of the CEO with the help of the executive teams, involves monitoring day-to-day risk of the bank and reporting it to the board.

On the other hand, the chairman acts as the main leader of the board by setting the agenda and ensuring that the board is effective in its various roles. The role of the chairman involves ensuring there is appropriate engagement and communication between executive and non-executive board members. He or she ensures that board members receive accurate, clear and timely information (Walker, 2009). In this regard, Walker (2009) argues that in boards where the CEO takes up dual roles, he or she is put in an unduly strong position enabling him/her to control information to and from the board. This is likely to increase the vulnerability of the corporation to major risks as the CEO has the capacity to block or stifle the possibility of a constructive challenge or inquiry.

In contrast, Boyd (1995) argues that a presence of a single, strong leader of the board and management team during periods of high turbulence may increase the speed and flexibility of corporate response to changing events, and outweigh any potential agency costs. He further suggests that there may be a lesser need for a powerful CEO in a more stable environment, which can reduce the risk of agency abuses. One of the components of the UK Board index is the role duality of CEO and chairman.

2.8.1.5 Board Size

In addition to the characteristics of directors, company size might promote board limitations, since a board which supervises multi-national and multi-business groups is faced with a large number of issues which may simply be too overwhelming to consider, requiring more time than is available. Consequently, board size becomes an issue, and on this there is much literature.

The size of the Board should reflect the different functions of the board, the relationship between executive and non-executive directors, the roles of different board members and their work-load, as well as board diversity and board communication. In the past decade, a number of studies have examined the impact of board size on firm performance and risk. A review of these reveals conflicting findings and the lack of consensus on the role played by board size in influencing firm performance and risk. Some empirical studies have linked board size to performance (Dalton et al, 1998; Mak and Yuanto, 2002), and a study by Coles et al. (2008) found that large boards positively affected corporations' performance, particularly for complex institutions that require more advisory input. Essentially, Coles et al. (2008) argue that large boards are more diverse, thus providing more ideas and links to

enable boards to make informed choices about corporate strategies and policies that will enhance efficiency and enable corporations to generate more revenue (Coles et al., 2008).

Conversley, Haniffa and Hudaib (2006), in a Malaysia study of 347 companies listed on the Kuala Lumpur Stock Exchange between 1996 and 2000, found a negative association between board size and market performance, providing evidence that large boards are seen as ineffective within the market, despite the wealth of expertise and diversity for the firm. Likewise, studies by Hermalin and Weisbach (2003), Lipton and Lorsch (1992), Pathan and Faff (2013), Yermack (1996), and Fairchild and Li (2005) among others, also suggest that the larger the size of the board the more likely that firm performance will decrease. They argue that large boards reduce efficiency in strategic co-ordination, discussion, and communication, preventing a detailed analysis of the most significant problems facing directors in supervising the management.

Similarly, proponents of the agency theory argue that a board that is large in size is likely to increase the monitoring costs of the corporation and further complicate communication and co-ordination. They further believe that smaller boards promote efficiency in strategic co-ordination, discussion and communication (Nanka-Bruce 2011). On the other hand, some studies have found no correlation between board size and the performance of firms (Wintoki et al., 2012). Specifically in connection with risk, some studies have reported that small boards positively affect bank risk-taking particularly in relation to total risk (TR), systematic risk (SYSR), and idiosyncratic risk (IDIOR) (Pathan, 2009).

According to the UK Corporate Governance Code (2012), the board should be of sufficient size to meet all the requirements of the business. Generally, this means that large firms require a greater number of directors. Moreover, larger firms tend to have a greater number of non-executive directors (Coles, 2008; Whidbee, 1997). The industry type and the complexity of decisions to be made may also determine the size of the board. Some industries demand complex decision-making, and require larger boards, whereas other industries are less demanding and need smaller ones (Di Pietra et al. 2008; Elsayed 2011). In this regard, Adams and Mehran (2012) argue that larger boards are a reflection of complex organisational structures, and merger and acquisition activities. In the specific case of banks, their boards often grow by incorporating directors from the various subsidiaries in order to facilitate information flow (Adams and Mehran, 2012); hence the size of the board varies from bank to bank.

The WR notes that listed banks have slightly more board members than median banks which have not been listed. On average, many banks have boards comprising 10-16 members. This is actually reflective of large companies generally, since a comprehensive

review of governance practice in the largest 150 companies in the FTSE rankings, from which the UK Board Index is composed, demonstrates the same size. In reviewing the size of UK company boards, the index takes into consideration, among others:

- The absolute number of board directors
- Workload of Chairman (full or part time)
- Number of non-executive, independent and foreign directors (excluding chairman)

Varied evidence has emerged in respect of the relationship between board size, composition, and firm performance. Board size and composition naturally differ among corporations, but when assessing board suitability, it is the heterogeneity of its members (gender, age, and number) that is important. Generally, boards are becoming smaller because of organisational and technological change requiring downsizing in an effort to cut costs. Indeed, the smaller the board size, the higher the firm's value.

However, Singh and Davidson (2003) noted that board size is inversely proportional to corporate performance, and Mak and Yuanto (2003) found firm value to be only slightly linked with the number of outside board members.

In fact, research on board size has shown mixed results internationally, with three different viewpoints emerging: one perspective suggests that larger board-size is directly proportional to the performance of the firm (Anderson et al., 2004); a second suggests smaller boards are more efficient and effective than larger ones because it is easier to co-ordinate members (Hermalin and Weisbach, 2003), and a third assumes the correlation between the board and subsequent valuation of the company is "U" shaped, with the optimal board size lying somewhere in the middle as boards that are too small fail to bring the requisite knowledge and skills, and those that are too large cause co-ordination and communication problems. In this connection, Goold (1996) advocates that unit decisions should be delegated to competent and committed management teams in order to avoid delays or inappropriate changes.

2.8.1.6 Board Meeting Frequency

Frequent board meetings are likely to increase the level of corporate performance (Adams and Ferreira, 2004). Indeed, research conducted by Ntim and Osei (2011) among 169 publicly listed companies of South Africa confirmed these assumptions, suggesting that the higher the frequency of corporate board meetings, the greater the capacity of the board to

provide effective advice. Additionally, it is known that the number of board meetings and the level of independence associated with these, impacts upon the performance of the overall company (Vafeas, 1999; Ryan and Wiggins, 2004). Infrequent board meetings negatively affect corporate performance, and short board meetings do not promote board effectiveness as a governing body. However, a high number of board meetings positively affects the monitoring quality of the corporate activities, discipline management, and hence improves corporate financial performance.

The UK Code of Corporate Governance (2012) suggests that all directors must be able to allocate sufficient time to perform their responsibilities towards the company effectively. Although less time may be required for smaller companies and those with less complex business models, the recommended ten board meetings a year, plus additional committee meetings and off-site visits should take place. This issue is addressed in the UK Companies' Board Index.

To assist the board in discharging its responsibilities, audit committees are usually formed, and the frequency of their meetings is also likely to affect organizational performance, with more meetings improving this. However, frequent audit committee meetings may fail to improve corporate performance per se because the audit committee only reports to the board about financial issues and the position of the firm. That said, according to Collins (2011), a positive relationship does exist between the frequency of audit meetings and overall company performance.

2.8.1.7 Ownership Concentration and Corporate Performance

Commenting on the lower trend of ownership in the US in comparison to other nations, Hasan and Butt (2009) suggested this may be the result of efforts made by controlling managers to discourage large holdings, implicit in which is the notion that managers are more powerful than shareholders, and can thereby dictate corporate control.

Undoubtedly, as noted by Demsetz and Villalonga (2001), the separation of ownership from control and allowing management to free float, plays a vital part in firm performance, especially where that free float is large. In this respect, Jelinek and Stuerke (2009) observed that free floats do not represent the optimal corporate ownership structure for firms. Indeed, Hasan and Butt (2009) believe that such structures result in sub-optimal corporate performance in some cases. Nonetheless, in the case of freehold banks, Cornett et al. (2007) observe that they exhibit less risk-taking behaviour compared to banks that are controlled by a single owner. Another view is that freehold is associated with varying degrees of risk – which has also been widely accepted by several financial experts and

academics (Lehmann and Weigand, 2000). Similarly, Black et al. (2006) argue that blockholder ownership decisions are bound to significantly affect corporate risk management and subsequently overall performance.

Furthermore, Gompers et al. (2003) believe that the type of industry has a significant bearing on whether an owner-controlled firm can outdo its manager-controlled counterparts in terms of performance. The nature and type of industry does indeed have a huge impact on performance. On this issue, Demsetz and Villalonga (2001) consider the asset specificity in an industry to be a variable in firm performance, claiming that where this is low owner-controlled companies perform better than manager-controlled companies, but that there is no significant difference when it is high. Role duality is known to influence corporate performance (Mike et al., 2007), and Iyala (2011) found a correlation between the number of external non-executives and the firm's ability to perform well financially.

Using a sample of 1,433 companies in 18 emerging economies, Karl (2002) found that the overall valuation of the firm is increased under the circumstances of ownership-control rather than being under the strict supervision of the managing body, and in another study of the twelve largest firms in Europe's leading economies, owner-controlled firms were seen to perform better within the UK as compared with the rest of the European firms (Thomsen and Torben, 1997).

While many previous studies focused on one or two governance mechanisms, others have examined the impact of different governance methods on the performance of a firm in the context of their earnings. The link in terms of two foremost measures of performance i.e. EVA (economic value added) and MVA (market value added) - and diverse variables for corporate governance including board composition, structure of leadership, ownership of the board, tenure and compensation of CEO, and CEO ownership etc., was explored by Black (1990) using survey data for 144 US firms. The results of the study reported a positive association between the economic value added and the combined leadership structure of firms, and a detrimental effect on the market value resulting from CEO salary sensitivity and external directors. But the research was unable to find conclusive evidence supporting the association of corporate governance measures of board ownership, CEO ownership, and CEO tenure with performance measures like EVA and MVA. Moreover, a consistent and solid impact of the industry's performance on the whole, was found on firm performance.

Concentration of ownership was also investigated by Haniffa and Hudaib (2006) among six other variables of corporate governance (board size, board composition, multiple directorship, CEO duality, and managerial shareholding) and two measures of company performance represented by 'Tobin Q and Return on Assets'. Their study in Malaysia

included 347 companies listed on the Kuala Lumpur Stock Exchange between 1996 and 2000, and found ownership concentration to be significantly associated with firm performance according to market and accounting performance measures. The ownership concentration variable for the study was measured by the top five substantial shareholdings. The results suggested that firms with diffused ownership are likely to have better market performance. Concentrated ownership was seen to have a positive association with accounting performance. The other finding was a considerable and negative link in terms of accounting performance and managerial ownership.

Another perspective explored by Haniffa and Hudaib (2006) was the ownership structure within the corporate sector generally in Malaysia, which is characterized by a concentration of ownership and cross-shareholding. It was observed that the concentration of ownership had a much larger power of explanation and significance. It helped provide support for a positive link in terms of the system of ownership concentration and cross-shareholding, and inefficiency, revealing that companies with a higher concentration of ownership lean towards being more inefficient.

2.8.1.8 Risk Management

Risk-taking behaviour is clearly influential in terms of corporate performance, and sound corporate governance can ensure that such behaviour is not detrimental to the organization. In the event that a company is met with the dilemma of selecting from a 'safe' or 'risky' project, the question of whether to opt for the expected lower returns from the safer investment as opposed to the seemingly higher returns from the riskier one. Where a company is well governed, it may decide it has the capacity to fund the more risky one (Gilley et al., 2002). However, the impact of risks on the organization is multi-faceted, bringing both positive and negative consequences to the firm. Negative impacts may involve a loss of revenue, loss of clients and other effects that derail the goals set by the organization.

Specifically in terms of the risks faced by banks, these can be summed up as: credit-related, market-related, liquidity-related, operation-related, capital-related, and reputational risks. Especially, the liquidity risk is pertinent to banks, as highlighted by the last financial crises (Gilley et al., 2002). The lessons learnt from the crisis indicate that banks grossly failed to appreciate their need for liquidity and to manage such risk in order to protect themselves as institutions, and the entire financial system. Consequently, policy-managers have exerted substantial efforts to alert banks to the need to attach more significance to liquidity risk management, via the BCBS (BCBS, 2010).

Considering the varying types of risk, Matthias and Glasgow (2009) explored a series of operational risks including fraud risks, physical risks, legal risks, and environmental risks. Additionally, they considered risks associated with capital, pointing out that in investing in a venture, an individual hopes for success and that environmental circumstances can affect this potential, hence requiring much attention to risk in that category. At the same time, Turnbull (2009) referred to the need for capital adequacy to perform financially and meet the shareholders' objectives of earning revenue, and general economic goals of keeping the financial system strong, and not running the risk of affecting other economies. Hence, capital risk management is important and should form part of overall corporate governance practice (Turnbull, 2009).

There is also the need to take account of reputational risks, which endanger the reputation of a well-respected company. Oldfield and Santomero (1997) have claimed that exposure to risk is an integral part of business, and that positive outcomes emerge when a firm is exposed to risk, since if it does not take any risks, it is very unlikely that it will ever move forward. Consequently, it is essential for management to devise procedures to ensure that the firm exploits the positive attributes of the particular risk involved, while simultaneously effectively managing the negative ones. Basically, management must identify and assess risks facing the organization on a daily basis, and exploit these in order for the organization to achieve its objectives (Matthias and Glasgow, 2009).

Several studies have outlined which measures of risk are critical in risk management, and public policy-makers have begun questioning the appropriateness of the system as practised in the financial institutions. The FSA (2008) claimed that the particular profile and role of risk management in the banking sector is under scrutiny, and the BIS (2008) also developed policy documents outlining a comprehensive risk management strategy and provided recommendations on the best governance structure. Walker (2009) recommended that risk should be an agenda priority to develop a workable corporate governance structure. Accordingly, it is recommended that there banks should establish dedicated risk level committees, composed of independent members as well as bank executives. However, a survey of 20 large banking institutions reveals that few have implemented the best governance practices developed in 2007, and that while dedicated risk committees have been established in the large banks, they have not planned to hold frequent meeting for members. Furthermore, Hau and Thum (2010) have observed that such committees lack adequate numbers of independent members who are knowledgeable about financial matters, and in a study by Hashagen al. (2009) of over 500 bank managers worldwide charged in the main with risk management, the majority were found to have implemented sub-optimal risk governance structures. Of the bank managers interviewed, 76% felt that

the risk functions within their institutions were stigmatized as a functional support system, and 45% believed that the risk committee members lacked adequate experience of how to manage risks issues. Furthermore, Ellul and Yerramilli (2010) investigated the relationship between independent and strong management, and the ability of banks to take risk, and overall performance, particularly through times of credit-related crisis. They focused on a total of 74 large banking corporations in the United States finding that having elevated Risk Management Index by 2006, low active derivatives on trade-off balance sheet, limited exposure to 'private label mortgage backed securities' and a small percentage of non-performing loans, reported a high sharp ratio and lower downside risk during the financial crisis.

2.8.1.9 Other Board and Company Characteristics

Many other board and overall company characteristics are demonstrated to influence corporate performance. The most common is the remuneration of board members, which has already been briefly mentioned earlier in the chapter.

Besides receiving incentives in the form of salaries and bonuses for their managerial function (Naciri, 2013), CEOs may also be incentivised by the prospect of equity ownership. This encouragement may align the interest of the CEO (as an agent) with that of the principal since the value of the CEO's equity holding is directly determined by the performance of the corporation (Kim and Buchanan, 2008). The aim of an effective remuneration scheme, including performance incentives (bonuses), is to attract highly qualified professionals and to cultivate their loyalty, especially when there is great demand for these people on the job market. However, a process of self-selection occurs in this respect, as the implicit motivational power of equity incentives attracts who are confident of their abilities and willing to risk part of their pay (Zattoni, et al., 2007). Clearly, the expectation is that board members are incentivised variously to be motivated to monitor and supervise the management in order to ensure they act in manner that upholds the interests of the corporation and its stakeholders, and not in their own economic interest to the detriment of the maximization of the shareholders' value (Zattoni et al., 2007). Much of the research to date demonstrates a strong correlation between accounting discretion and poor governance quality as evidence that lax governance structures encourage managerial opportunism (Becker et al., 1998; Klein 2002; Menon et al., 2004). Thus it is crucial to consider the level of remuneration in Board of directors, which is featured in the UK Board Index in following categories:

- Chairman remuneration

- Senior non-executive total remuneration
- Non-executive director basic fee
- Additional fees except committees
- Fees paid in shares

The board characteristics of five biggest UK banks as encompassed in the UK Board Index are presented in Table 2.4

Table 2.4: Board Characteristics

	HSBC	Lloyds Banking Group	Royal Bank of Scotland Group	Barclays	Standard Chartered
Financial year end	Dec-11	Dec-11	Dec-11	Dec-11	Dec-11
Total number of directors	17	9	12	12	17
Chairman full or part time	Part	Part	Part	Part	Part
Chairman also CEO?	No	No	No	No	No
Non-exec directors (excluding chairman)	14	6	9	9	10
Independent non-executive directors (excluding chairman)	14	6	9	9	10
Foreign non-executive	7	1	2	4	1
Women non-executive	4	2	3	2	2
Executive directors (excluding chairman)	2	2	2	2	6
Foreign executives	0	1	1	1	3
Women executives	0	0	0	0	0
Average time of service non-executives	4,1	2,3	2,7	4,4	6,2
Chairman tenure	1,4	2,7	3,3	5,3	2,8
CEO tenure	1,3	1,2	3,5	1,3	5,5
Average age of non-executives	60,9	59,7	60,5	59,8	63,6
Average age of executives	52,5	48,5	53	55,5	52,3
Board meetings (including strategy sessions)	9	9+7	9	8	10
Chairman remuneration (£000)	5,452	700	750	750	650

Senior non-executive director total remuneration (£000)	166	125	150	188	385
Non-executive director basic fee (£000)	95	65	72,5	80	100
Additional fees except committees (£000)	No	No	No		No
Fees paid in shares	No	No	No	28%	£500,000

Source: UK Board Index (2012)

A company characteristic known to have a relationship with company performance, is CEO turnover, as identified by Laustin (2002) who conducted a study in Danish firms using longitudinal data, and found this to have an inverse link with corporate performance. Several measures of corporate performance and corporate governance were employed, the subsequent results confirming the principal-agent theory (detailed in Chapter Three). Essentially the threat of turnover ensures that the CEOs are always acting and implementing decisions which are best for the shareholders' interests. Furthermore considering the role of the chairperson and the family ties within the management and ownership of the company mean that a substantial link in terms of the performance of the firm, and the CEO turnover exists.

Judge et al. (2003) examine the relationship between board structure and corporate performance in the context of Russia, testing their hypotheses using survey data. Despite using a small sample size of the sample, their predictions grounded in the theoretical framework, seemed to hold weight, and apart from finding the negative link between firm performance and informal CEO duality already mentioned in section 2.8.1.4, they determined that the more vigour a company shows in pursuing a strategy for retrenchment, the more negative the link in terms of the firm's performance and proportion of directors on the inside. These findings, in a larger context, indicate that for firm performance to be efficient, corporate governance needs to be effective as well.

While many previous studies have focused on one or two governance mechanisms, others have looked into the impact of different governance methods on firm performance in the context of their earnings. Black's (1990) survey of 144 US did this, using the two foremost measures of performance i.e. EVA (economic value added) and MVA (market value added), and diverse corporate governance variables including board composition, structure of leadership, ownership of the board, tenure and compensation of CEO, and CEO ownership etc., but also considering performance of the industry generally. He found a positive association between the economic value added and the structure of company leadership, but a detrimental effect on the market value resulting from CEO salary sensitivity and

external directors. However, the study was unable to find conclusive evidence supporting the association of corporate governance measures of board ownership, CEO ownership, and CEO tenure with performance measures like EVA and MVA. It was the consistent and solid impact of the industry's performance on the whole that was seen to massively influence company performance.

However, there are arguments that quite specific company features do impact on overall performance. Indeed, it is argued that board meetings are inefficient, rarely communicating the relevant information to the relevant parties (Jensen, 1993). Furthermore, studies have also indicated that the characteristics of the board may be reliant on characteristics of the company (Hartzell and Starks, 2003).

The corporate structure must be seen to be operating effectively and ethically, as found by Van de Veldeet al. (2005). In their study it was clear that while it is important for a business and the investors to pursue long and short-term profits, in a world that is constantly connected and where ethical awareness is becoming top priority, it is just as important for the corporate structure to act in a socially acceptable manner. Additionally, Bhagat and Bolton (2008:4) show that

“governance measures are correlated with future stock market performance ... In several instances, inferences regarding (stock market) performance and governance relationship do depend on whether or not one takes into account the intrinsic relationship between governance and (stock market) performance.... if a firm performs poorly then the probability of disciplinary management turnover is positively correlated with the stock ownership of the board members and the independence of the board itself”.

Furthermore, according to Gompers et al. (2003) using the G-Index which is, “based on only one aspect of corporate governance which is different from most other indices which provide for many alternative methodologies”, companies already benefitting from good corporate governance are under less threat of being subjected to disciplinary turnover of the managing body, despite the company's overall underperformance.

Many studies of corporate governance and firm performance have been limited to one country (Zhou, 2001), and hence it is not surprising that the deductions from these vary. Clearly, it is necessary to fully comprehend the level and magnitude of these variations, and the regulatory environment present in different countries must be taken into account (Becker et al., 2011). Likewise, factors like external financing and the dependency of the firm with respect to it, the type of ownership structure in question along with various other investment-

related opportunities that dictate the value of corporate governance, are possible reasons for differences in outcome.

Seemingly, a division exists amongst researchers on the impact of corporate governance on firm performance, with one group arguing that the former has no significant effect on the latter (see Gompers et al., 2003), while the other observes a higher level of performance resulting from well-governed structures, which in themselves attract higher demand in terms of stock purchasing, with investors even willing to pay more than the market value.

Giroud and Mueller (2011) show that firms with weak governance demonstrate worse operating performance, equity returns, and firm values, than well-governed firms. However, these examples only hold true in non-competitive industries. Such firms also had labour productivity which was significantly lower, coupled with input costs which were higher. They create acquisitions which destroy value, and again this is limited to non-competitive industries. Finally, such firms in non-competitive industries have a higher likelihood of being the target of hedge fund activists, which suggests that investors need to act in order to get rid of inefficiency. Hsu (2013) analysed the effects of the organizational mode on the financial structure of a company. He investigated efficiency and outlined the impact of a minority shareholder's restricted protection in the context of firms operating in pyramidal formations, succeeds in obtaining finances from external sources. The research also examined the function of the internal capital markets in relation to pyramidal formations, and outlined the links between governance structures and company performance.

2.8.1.10 Summary

Clearly, effective corporate governance through the mechanisms of the board of directors and audit committees, promotes the ethical behaviour of a firm and limits the opportunity for insiders to take advantage of minority shareholders. Mitton (2002) addresses this issue, finding that firms that perform well place top priority on the disclosure of comprehensive accounting information to owners outside the company. Indeed, a survey conducted in the US and the UK revealed that companies that are directed by ownership perform much better than those directed by the management, and Mak and Yuanto (2003) noted that large shareholders have a bigger say in matters and are able to better monitor the situation, resulting in a healthier turnover rate of directors.

However, since the latest financial crisis, the role of executives has seen change as both the Turner Report (March 2009) and the Walker Report (2009) have favoured the alignment of risk and finance in the form of a Risk Committee and Chief Risk Officer (CRO) position at board level. The practitioner literature on risk management suggests that the CRO should

focus on developing fruitful interactions between various board members, taking the role of “strategic business advisor” (KPMG, 2011:27). Power (2007), further suggests that the CRO role should not be one of reactive control agent, but of proactive assessor and communicator of uncertainty, capable of operating as a potential partner to business decision-makers.

2.9 Corporate Governance and the Overall Issue of Risk Management

Thus far, the issue of risk management has been discussed as a component of an overall corporate governance process leading to improved performance. However, as a concept, risk management is worthy of greater discussion, since corporate governance and risk management are known to go hand in hand, and this is especially so in the case of the banking sector. Therefore, it is safe to assume that the absence of Corporate Governance would make it impossible to undertake effective risk management (Basel Committee, 2005). However, despite its ethical significance, risk management is far from being touched upon empirically. Although, at first glance, the July 2010 amendments to the UK Corporate Governance Code in respect of risk management might appear minor, it becomes evident that this area is gaining increased importance, and as urged by Flannery (2010), the Financial Reporting Council should consider updating the underlying Turnbull guidance in order to provide further assistance for organizations when complying with the heightened emphasis.

2.10 Corporate Governance, Ownership and Risk-taking in Banks

According to Allen and Gale (2000), managerial ownership is considered a critical factor, particularly when examining risk-taking in banks. Most studies find that higher shareholdings amongst directors and officers can significantly induce risk-taking behaviour by banks, and Boubakri et al. (2003) noted that ownership and risk-taking high dependency on the health status of the existing banking system. Malherbe and Segal (2001) also argued that the relationship can particularly pronounced at times of distress, with the reverse being the case during periods of prosperity. Pathan’s (2009) empirical analysis showed that most holding companies among US banks have high risk assumptions, especially when there is a high board representation. Hence, there are strong reasons to explain why the corporate governance structure in the US was a significant factor that influenced the bank defaults. Linking this with the recent financial crisis, Beltratti and Stulz (2012) conducted an analysis of governance and ownership structures with respect to the potential bank risks. In their study, they noted that those banking institutions with better governance systems in terms

of a friendly board structure and shareholders, register poor performance and low stability. They also showed that corporate governance systems significant influence the ownership and risk-taking behaviour of banks (Omran, 2006).

2.11 Corporate Governance and Enterprise Risk Management

Corporate governance enhances enterprise risk management activities. Anne and Ryan (2003) argued that ERM is a process that is influenced by the management team, board of directors, and other employees in an organization. Its application is mainly in strategy-setting in relation to various enterprises, and in examining events that may prove detrimental to the entity. Miccolis (2000) claimed that robust ERM frameworks are critical to the achievements of company objectives, including executable strategies, effective and efficient operations, a reliable system of reporting and ensuring compliance to the regulations and laws. On the same note, Mitroff (2000) suggested that the corporate governance policies and key statues established in the last few decades mainly address the management of risk in their organization. They further added that ERM applications and principles should start at the level of the board of directors. Meulbroek (2000) claimed that the board should take into account, several activities when examining the policies that would govern the internal control of the firm, as follows: understanding the extent and type of risks faced, the risk categories and degree that the company can bear, the possibly of the risks materializing, the capacity of the company to overcome the impacts associated with these risks, and finally the costs of operating a control process aimed at managing the potential risks in the company. Young and Tippins (2000) stated that the determination of how effective the internal control process is, should be one of the main responsibilities of the board. In addition, the management activities form part of the board's responsibility within the internal control system, and all of these must be achieved through efficient and effective corporate governance.

2.12 Corporate Governance and Risk Management

There are many types of risk that affect business organizations, and many classifications have emerged based on COSO (2004) investigations. The risks in the banking sector have already been discussed in section 2.8.1.8. In the non-financial sector, strategic risk and operational risk represent the core risks, since financial risk and hazard risk result from environmental factors over which the firms involved have no control, and as noted by Kleffner al. (2003), do not arise because of the business decisions of the firm. However, for financial institutions like banks, the management of financial risk or hazard risk is the core business.

According to Sundaram and Inkpen (2004), good corporate governance helps to improve risk management in both banks and non-financial institutions; and Pathan (2009) looks at the issue from the other way round, claiming that risk management and assessment are among the most significant factors affecting corporate governance. Brown (2001:9) has established taxonomy of risk which appears as Table 2.5.

Table 2.5: Risk Taxonomy

Category	Component	Description
Financial Risk	Risk from Market	Harmful movements in pricing (including stocks or commodities) or rates (including rates of interest, or rates of foreign exchange).
	Risk from Credit	This is where the counterparty is not able to hold up its agreed terms as per the contract, either because of its unwillingness or a lack of ability to make timely payments.
	Risk from liquidity	This would include a firm's inability to keep up its obligations because of problems relating to liquid assets or cash flow. This also encompasses market liquidity i.e. when an asset can be converted to cash, but doing so would result in a loss of value.
Operational Risk	System Risk	IT will cease to function properly; or IT will not be able to meet with the demands at hand. This will result in the firm being exposed to loss which is in essence avoidable.
	Risk of Human Error	A contractor agent or employee will not be able to deliver the target that has been allotted to him/her. This will affect the company on the whole. It could result in a potentially large monetary loss.
Strategic Risk	Legal and Regulatory Risk	Lawsuits that stem from both civil and criminal courts. This can include costs of compliances, sanctions, and other limitations that are imposed by the political authorities of the environment that the firm is functioning in.
	Risk from Business Strategy	Loss that stems from poor decisions made by the management. This would include pricing for products, entry and exit from the market, acquisitions, mergers and development of new products.
Risk of hazard	Liability in terms of officers and directors	Exposure of different managers from the corporate environments to the claims of alleged

		mismanagement by government agencies, shareholders, employees etc.
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Source: Brown (2001:9)

Several studies have attempted to explore the way in which companies are governed (how these risks are managed) with how they perform. However, Bhagat and Black (2002) find an insignificant relationship with the management of these risks and firm performance.

It is rational to presume that well-governed companies have a higher probability of having better structures, processes, and systems in place to enable them to maximize their profitability. With the maximization of profitability, firms will be able to increase their shareholders' wealth, which in turn increases their reputations. With an increased reputation as well as profitability, companies are able to command higher stock prices in the market. Hence, it becomes clear that corporate governance functions instrumentally to improve the value of the firm.

2.13 Studies Informing the Literature Review

The analysis of literature suggests that several studies have been conducted in the field of corporate governance, financial risk and corporate performance. The studies that have been used in the study have been summarized in Table 2.6.

Table 2.6 indicates the various studies analysed in producing this literature review.

Table 2.6: Studies Informing the Review

Study	Country	Aims and Objectives	Research Methodology	Independent Variables	Dependent Variables	Findings
Anderson et al. (2004)	United States	The relationship between board characteristics, accounting report's reliability and the cost associated to debt.	Empirical Investigation.	Board Interdependence Board Size Greater Audit Committee Independence Audit Committee Size	Corporate Debt Yields	- Debt is lower for larger boards, as these firms are viewed as effectively monitoring their financial accounting processes.
Lipton and Lorsch (1992)	United States	To evaluate corporate governance framework	Literature Review	Board Size Complexity of Information Cohesiveness in Board Top Management Power Accountabilities of Board	Corporate Governance	A smaller sized board helps make the performance better, since communication and decision making suffer as groups become larger

Study	Country	Aims and Objectives	Research Methodology	Independent Variables	Dependent Variables	Findings
Klapper and Love (2004)	Brazil Chile Hong Kong India Indonesia Malaysia Pakistan Philippines Singapore South Africa South Korea Taiwan Thailand Turkey	To determine the relationship between legal environments and firm level governance and to analyse the link between high operating performance and corporate performance.	Questionnaire Method Empirical Investigation	Legal Environments and Legal systems High operating performance	Firm level governance Corporate Performance	- Tobin's Q shows that good governance leads to improved performance in the context of operations, this is specifically true in cases where the legal systems are much weaker
Bhagat and Black (2000)	United States	To analyse the relationship between board interdependence and corporate performance	Empirical Investigation.	Board Interdependence	Corporate Performance	- No relationship

Study	Country	Aims and Objectives	Research Methodology	Independent Variables	Dependent Variables	Findings
Fairchild and Li (2005)	United States	To determine the relationship between board directors quality and the firm performance	Empirical investigation	Board Directors Quality	Firm Performance	The results of the study suggest that
Eisenberg et al. (1998)	Finland	The impact of board size on firm's profitability and value.	Empirical Investigation. The sample size consisted of 900 Finnish firms.	Board Size	Firm Profitability. Firm Value Firm Performance	The results of the study indicated that the relationship between the board size and firm value was inversely proportional.
Hartzell and Starks (2003)	United States	The aim of the study was to measure the impact of institution investors on ownership concentration in organizations.	Empirical investigation	Institutional Compensation Pay for Performance	Ownership Concentration	Large institutional shareholdings positively impacts performance

Study	Country	Aims and Objectives	Research Methodology	Independent Variables	Dependent Variables	Findings
Cornett et al. (2007)	United States	The aim of the study was to investigate the impact of institutional ownership on corporate operating performance		Director and executive officer stock ownership Board director characteristic CEO duality Board Size Age of the CEO Firm Size CEO pay performance sensitivity	Firm Performance	- Large institutional shareholdings positively impacts performance
Gompers et al. (2003)	United States	To determine the relationship between corporate governance and shareholder rights	Empirical Investigation	Firm Value Shareholder Rights Agency Costs	Corporate Performance	The findings suggest that corporate governance is strongly associated with stock returns. However, the researchers contend that there is need for further research to determine the relationship since casualty cannot be reached.

Study	Country	Aims and Objectives	Research Methodology	Independent Variables	Dependent Variables	Findings
Lemmon and Lins (2003)	East Asian Countries: Hong Kong, Indonesia, Malaysia, the Philippines, Singapore, South Korea, Taiwan, and Thailand	To study the impact of ownership structure on the firm performance, during the 1997 financial crisis in East Asian countries.	Empirical investigation and analysis.	Ownership structure	Corporate Governance Firm Value	The results of the study show that the control of manager and family are separated, then there is increase in the .
(Mitton 2002)	Indonesia Malaysia Korea Philippines Thailand	The aim of the study was to investigate the impact of corporate governance on East Asian financial crisis.	Empirical Investigation of 398 firms, whose financial data had been reported to the Worldscope.	Stock Returns ADR	Firm Performance Disclosure Quality Ownership Concentration	-firms with better disclosure and outside oversight have better performance.

Study	Country	Aims and Objectives	Research Methodology	Independent Variables	Dependent Variables	Findings
Thomsen and Torben (1997)	European Countries: Austria, Belgium, Denmark, Finland, Germany, France, Spain, Italy, Norway, Sweden and Netherlands.	To determine the relationship between ownership structure and economic performance.	Empirical Investigation	Ownership Concentration Ownership Share	Financial Performance of the firm Company Performance	In the market-based British system, the positive effect of ownership ties to financial institutions is better than in continental Europe.
Bhagat and Bolton (2008)	United States	To determine the relationship between corporate governance and firm performance.	Empirical Investigation	Corporate structure ownership Board Ownership Board Interdependence CEO-Chair Duality Capital structure	Corporate governance Firm performance	If performing poorly then the likelihood of turnover (disciplinary management) has a positive correlation with the board members' stocks and independence of the board itself. It is important to note though that firms which are better governed by BCF and GIM have a much smaller chance of experiencing disciplinary turnover, irrespective of how poorly their perform.

Study	Country	Aims and Objectives	Research Methodology	Independent Variables	Dependent Variables	Findings
Becker et al. (2011)	United States	To determine the impact of large shareholders on firm performance and firm policies	Empirical Investigation	Large shareholders	Firm Performance Firm policies	The results of the study suggest that firm performance improves in the presence of an individual or company owning a larger proportion of shares.
Giroud and Mueller (2011)	The researchers did not mention specific countries. Firms taken consisted of 3241 companies, which were taken from Investor Responsibility Research Center Database.	To verify that organizations from non-competitive industries can benefit from corporate governance as compared to firms from competitive industries.	Empirical investigation had been adopted by the researchers	G- Index measure for corporate performance. ATI Index E-Index	Firm Value Product Market Competition	Firms with weak governance have lower operating performance and firm value, but only in non-competitive industries.

Study	Country	Aims and Objectives	Research Methodology	Independent Variables	Dependent Variables	Findings
Bianco and Casavola (1999)	The study had been conducted in Italy	The aim of the research was to investigate the relationship between Italian corporate governance system and firms performance.	Mixed method of research: Investigation of Corporate governance impact on financial structure of the organizations. Direct test to analyse firm's ownership and control structures.	Firm ownership	Firm's performance	The findings of the study suggest that separated firm ownership increases the firm financial performance. s
Solomon et al. (2000)	United Kingdom	To study corporate governance framework from UK perspective and understand the framework for corporate risk disclosure.	Quantitative method. Questionnaire	Risk Disclosure Corporate governance	Investment Decisions Demand for Information	The characteristics of the funds and their investment horizons influence the practice of investors

Study	Country	Aims and Objectives	Research Methodology	Independent Variables	Dependent Variables	Findings
Tomar & Bino (2012)	Jordan	Their study focused on investigating the impact of corporate governance mechanism such as ownership structure, board size and composition of the board on the bank performance.	Empirical Investigation	Ownership structure Board Size Board Composition	Bank Performance	Board composition and ownership structure had positive impact on the bank performance. Their findings also revealed that banks that had institutional majority ownership had efficient and effective performance. The size of the board did not have impact on the performance of the bank.

Study	Country	Aims and Objectives	Research Methodology	Independent Variables	Dependent Variables	Findings
Erkens et.al (2012)	30 different countries	To study the impact of corporate governance on financial institutions, which were subjected to financial crisis of 2007 to 2008	Empirical Investigation	Institutional Ownership Board independence	Stock returns	Organizations with independent boards and higher institutional ownership had suffered from “worse stock returns” during the crisis. The study also revealed that as institutional ownership increased, risk taking increased before the crisis. During the crisis, board independence helped in raising equity during the crisis. When equity capital raisings increases, the firms were able to avert the negative outcomes of the crisis.

Study	Country	Aims and Objectives	Research Methodology	Independent Variables	Dependent Variables	Findings
Bopkins (2013)	Ghana	To study the understand the impact of ownership structure and corporate governance on the bank efficiency, using the banking industry of Ghana as case study	Empirical investigation	Ownership structure Board Size	Bank Cost Efficiency	Foreign banks had better performance as compared to domestic banks. The study came to the conclusion that managerial ownership has negative impact on the bank's cost inefficiency. Banks that have inside ownership are known to have lesser profitability. Governance with a large board size can help in improving the profitability of the banks but can decrease their cost efficiency. .
Aebi et.al (2012)	United States	To investigate the relationship between risk management, corporate governance and bank performance at the times of crises	Empirical Investigation	CRO significance Board of Directors Role Board Size CEO ownership Board independence	Bank performance	When CRO reported to the board of directors, the banks performed better during the crisis as compared to those banks where CRO reported to the CEO. Corporate governance variables did not have positive or negative impact on bank performance during the GFC 2008.

Study	Country	Aims and Objectives	Research Methodology	Independent Variables	Dependent Variables	Findings
Leventis et.al (2013)	United States	To determine whether the commercial banks, which are listed in US have high degree of strict and efficiency financial and reporting system since they have highly effective and efficient corporate governance structures	Empirical Investigation	Ownership structure Board size Board independence	Financial reporting system efficiency	Banks with strong corporate governance structure had efficient and effective financial reporting mechanisms and structures.

Study	Country	Aims and Objectives	Research Methodology	Independent Variables	Dependent Variables	Findings
Peni and Vahamaa (2012)	United States	To investigate the impact of corporate governance on banks performance during the GFC 2008	Empirical Investigation	Corporate governance mechanisms such as board size, type of ownership, independent directors and board independence	Stock market performance Profitability of the banks	The findings were mixed. Banks that had adopted strong corporate governance mechanisms had higher profitability during the crisis. However, corporate governance mechanisms if it is strong, it had negative impact on the "stock market valuations". The results of the study also indicated that after the GFC 2008, the banks with strong corporate mechanisms had positive impact on stock returns.

Study	Country	Aims and Objectives	Research Methodology	Independent Variables	Dependent Variables	Findings
Al-Musali & Ismail (2012)	Gulf Council Countries: Bahrain, Saudi Arabia, Qatar, United Arab Emirates, Kuwait and Sultanate of Oman.	To investigate the impact of corporate governance mechanism on bank performance in Gulf Council Countries	Empirical Investigation	Board size Ownership structure Independent directors	Bank performance	Bank performance was affected by the ownership structure, the use of independent directors and board size. The relationship between bank internationality and bank performance was insignificant. Adoption of Shariah and Islamic rules in banks had positive impact on bank performance
Jizi et.al (2014)	United States	To study to investigate the relationship between corporate governance and corporate social responsibility (CSR), using the banking industry as the case study	Empirical Investigation	Board meetings Board size Audit committee attributes Board independence	Corporate social responsibility	Independent and large boards had stronger CSR mechanisms. CEO duality also had positive relationship with CSR mechanisms.

Study	Country	Aims and Objectives	Research Methodology	Independent Variables	Dependent Variables	Findings
Berger et.al (2016)	United States	To study the impact of corporate governance in relation to failures of banks during the crisis	Empirical Investigation	Ownership models, Management Structures of compensation	Bank failures	“High shareholdings of lower-level management and non-chief executive officer (non-CEO) higher-level management increase failure risk significantly” (Berger et.al, 2016)
Morekwa Nyamongo & Temesgen, K. (2013)	Kenya	To investigate the impact of corporate governance on banking performance of Kenyan banks	Empirical Investigation	CEO duality Board size Independent directors	Banking performance	Board size impacted banking performance. The large board size had negative impact on performance. CEO duality did not have any impact on performance, whereas the existence of independent board directors was associated with enhanced and superior bank performance.

2.14 Conclusion

This chapter has presented a comprehensive review of the literature pertaining to the global financial crisis, the situation in the UK particularly, and the entire issue of corporate governance in banks. The review has been undertaken to underpin the rest of the study, and because banks play important monitoring and governance roles, which enable their corporate clients to safeguard their credit against corporate financial distress and bankruptcy. A large number of variables have been identified as having an impact upon bank's ability to achieve this objective, and ultimately be sufficiently profitable to enable investors to reap a profit. These variables have been chosen because the global financial crisis emerged as a result of the weakness in the governance at corporate level which permitted financial institutions to design policies which they believed would bring profit maximization. In response to those ill-conceived policies, came firm-level problems, including conflict of interests in the same entity. These events, together with the interlinkages between various financial institutions, especially the large global institutions, and the real-estate bubble, forced the collapse. However, it is notable that during this crisis, banks performed differently according to the business models they had adopted. That is to say, that banks with more Tier I capital (generally in countries where stronger capital supervision is present) and a higher loan to total assets ratio, performed much better than those with more shareholder-friendly boards. Moreover, a larger deposit base and more liquid assets were associated with higher returns, and banks with stronger internal risk controls performed better.

Policy-makers responded to the financial crisis by implementing a large array of financial reforms. The most critical for the banking sector included: the adoption of Basel III capital requirements, agreement on liquidity standards – the Liquidity Coverage Ratio (LCR), some progress on reducing too-big-to-fail, more intense supervision, some proposals of national resolution schemes (including bail-in instruments), enhancements to the 'securitization model', adoption of principles for sound (anti-excessive risk-taking compensation practices), and other reforms connected with data collection and derivative markets (Claessens and Kodres, 2014).

All these policy requirements called for a different approach to corporate governance in the banking sector, requiring more effective equity governance and debt governance, a consideration of the different expectations of management, risk-prone shareholders, risk-averse debt holders and supervisors. Moreover, there were calls for the more efficient separation of the management and control function, the creation of a separate board risk

committee or an independent chief risk officer (CRO), and the revision of complex and opaque bank structures in order to improve group-wide corporate governance (Hopt, 2011). In order to comply with new capital requirements, banks are expected to change their evaluation of risk-adjusted performance.

Based on a survey conducted by McKinsey and Company (2011), several lessons relating to the financial crisis and its causes and consequences, have been learnt which must be embedded in corporate governance mechanisms. The first is the need to find a new equilibrium in terms of performance benchmarks, industry structures, business models, financial structures, taxation, products, pricing, conduct and remuneration, and these are issues to be addressed by academics and practitioners. The second is the need to develop a more strategic approach to deal with chaotic bank responses, adjustments, damaging over-reactions and distorted reactions to short-term regulations and other events. The optimal structure for regulatory and economic capital must be found, a thorough revision of the expectations of both banks and their investors in respect of their return on equity needs to take place. Finally, there is also an urgent need to restore the deep-rooted crisis of investor confidence in the banking sector.

The literature highlights that corporate governance plays a critical role in enhancing performance and reducing corporate risk

Chapter 3: Conceptualising Corporate Governance

3.1 Introduction

Corporations have become powerful and dominant institutions in the business world, influencing not only economies, but also various other parts of the social landscape. With the advent of globalization, companies are far more geographically dispersed with little control from governments, thereby emphasizing the need to ensure they remain ethical and are held accountable for their actions, and hence, increasing the need for corporate governance (Crane and Matten, 2007), which can ensure the maintenance of quality and high standards. Hence, corporate governance is present in all kinds of entities, business, or non-profit (Clark, 2004).

Over the years, scholars have developed different frameworks of what corporate governance entails, and this chapter introduces the theories identified by Sanda and Mikaila and Garba (2005) as being appropriate for conceptualizing corporate governance. Particularly, it considers Agency, Stakeholder, Stewardship, Resource Dependency, Transaction Cost, Political, and Legitimacy theories, focusing on Agency and Stakeholder theories, which it critically examines and compares, as the two most associated with the banking sector.

3.2 Agency Theory

As one of the most prominent theoretical frameworks of corporate governance, agency theory focuses on the relationship between an organization's management and shareholders. The theory was first conceived by Berle and Means (1932) based on data from US companies. Later, Jensen and Meckling (1976) provided more depth to the theory by developing the issue as an agency relationship, which can be described as a contract whereby one party (principal) engages another party (agent) to undertake services on its behalf. In modern corporations, this type of relationship involves the delegation of a mandate to managers to make certain decisions that are in the best interest of the owners or shareholders of the corporation (Jensen and Meckling, 1976; Padilla, 2002; Psaros, 2008). Hence, it is essentially an easy theory to understand since as Watts and Zimmerman (1983) observed, it breaks down the corporation into two parties, the agents and the principals, and subsequently, highlights the drawback that agents might act in their own self-interest rather than the interest of the principals. This potential is claimed by Jensen

(2002), to result in companies with a higher degree of agency being threatened by other firms in the environment, and it is thus necessary to control for agency-related problems.

The source of these problems derives from the information asymmetry which occurs when one party (e.g. corporation management) has better or timelier information than the other party (e.g. shareholders). Managers, of course, possess such internal knowledge, and this can be used to gain advantage over the firm's owners who are absent from the day-to-day running of the firm, thereby allowing managers to fulfil their self-interest, which may subsequently place the firm and its shareholders at risk (Fernando, 2009; Gomez and Russell, 2005). A further problem arises from the fact that there may be a large number of shareholders, and the self-interests of all these principals may be conflicting in nature (Davis et al., 1997).

Given the need to monitor managerial actions, and to mitigate any losses that might arise through poor monitoring, the agency problem is largely connected with costs. In this respect, bonding costs are those representing the value of the reduction in welfare experienced by the principal due to discrepancies between the agent's decisions and those decisions which would maximize the principal's revenues. Thus, the costs are associated with the different interests of the two parties (principal and agent) (Jensen and Meckling, 1976), and essentially relate to the structures which need to be introduced to diminish the risk of managerial misbehaviour.

Reductions in agency costs can be achieved by various methods. For example, in the specific case of the banking scenario which forms the focus of this study, where managers are found to be liable for contravening banking regulations by either disclosing inaccurate information or engaging in very risky practices that put shareholders, depositors, creditors and other stakeholders at risk, they can be sanctioned by financial regulators (Sign, 2012).

In all types of enterprise, however, top management activities might be monitored by the board of directors, which is considered the most important internal mechanism (Gomez and Russell, 2005). The board not only controls the decisions of the top managers, and their compliance with shareholder interests (Pige, 2002), but also motivates managers to create and maximize profits for those shareholders (Laeven and Levine, 2009; Ellul and Yerramilli, 2013). That said, the high-risk appetite of shareholders may in turn be in conflict with the interest of stakeholders such as depositors, creditors, and deposit insurance agencies (Mehran et al., 2011), and the board would be a forum where such issues would require debate.

Another means of reducing agency costs is to provide incentives that are tied to measurable results, such as financial rewards and performance based contracts. Usually, such incentives are provided through the remuneration package, thereby encouraging managers to act in the best interest of shareholders (Fernando, 2009).

Agency costs do trigger the need for market regulation to protect stakeholders such as creditors, the public and other customers. However, market imperfections may occur when external financiers use their market power to make trade-offs with alternative funding opportunities, thereby creating oligopolies (Thépot and Netzer, 2008).

Although agency theory is considered to be one of the most prominent theoretical corporate governance frameworks, it has been criticized for undermining corporate governance by suggesting that total control over management is neither possible nor required. The core assumption in this argument is that when employing agents, shareholders must accept that a particular level of self-interest behaviour will occur. Thus, the goal of corporate governance is to check any abuses in this trade-off. This outlook undermines the essence of corporate governance, which seeks to regulate and supervise management in order to ensure shareholders' interests are maintained (Fernando, 2009).

Historically, the principles of corporate governance evolved as a mechanism to deal with the agency costs in the Anglo-Saxon model that is largely prevalent in the UK and the USA. This approach requires publicly-listed companies to have unitary boards, independent outside directors, and board committees. In line with the underlying assumptions of agency theory presented earlier, the approach focuses primarily on the fact that shareholder value is increased mainly by richly-rewarded top executives.

Granovetter (1985), in his literature of embeddedness and trust, argues that the agency problem can be dealt with by a process of carefully selecting, monitoring and sanctioning agents, and Shapiro (2005) takes up this theme, suggesting that adverse selection can be avoided by implementing a structure whereby agents are recruited from within a network of personal relationships. Such a process of agent selection may not solve the problem of goal conflict, but it will surely reduce their effects (Laffont and Martimort, 2002). Practically however, there may not exist a personal relationship between the two (Crowther, 2011). Given the fact that the principals cannot perfectly monitor the behaviour of agents, they tend to set imperfect criteria with which to compare performance, and which agents can manipulate to give the appearance of good behaviour (Mitnick 1992).

In reality, the conflict of goals between the agent and the principal can only be solved by an incentive system that removes the conflict and aligns their mutual self-interests (Jensen,

1986), but this still leaves the agent with the dilemma of having to overcome the conflicting self-interests of the various principals, and this raises the issue of loyalty to certain principals (Shapiro, 1987).

Certainly, there are several issues requiring consideration in the principal-agent theory, and not surprisingly, this theory does dominate the entire corporate governance debate compared to the other models, with contributions from many researchers exploring certain facets of the theory. For example, Jost (2001b) observed that the theory addresses the duties and responsibilities assigned by the principals to the other employees within the organization; and Hendry (2002) notes the focus on the incentive and monitoring system and the need to streamline principal-agent interests. Similarly, Laffont and Martimort (2002) consider the contractual relationship between principal and agent, stressing the need for this to be properly expressed. Clearly, that contractual relationship is one that aims to maximize utility, yet as asserted by the property rights theory, it is difficult to effectively map the relationship between the management and owners (Alchian and Demsetz, 1972), and hence, it is important to establish systems and structures to control and monitor the management practices. Among these systems should be a mechanism for separating finance and management (Ghoshal and Moran, 1996).

Jensen and Meckling (1976) argue that agency theory does assist in delineating the link between the structures relating to ownership and management, and that where there is no cohesion between the two parties, the model can in fact be used to create cohesion between the aims of the owner and the management. However, the theory tends to depict the employee as an individual element, thus giving the impression that his/her behaviour is based on logic, when in reality the most important thing in this regard is the system of remuneration and penalty. In contrast, Crowther (2011) asserts that no link exists between the two, which thus renders agency theory as a cause of the failure of the corporate governance mechanism in some contexts.

It should also be noted that there is an agency cost related to each and every relationship, such as the hiring costs, costs related to bad selection, costs due to difference in preferences, costs related to motivation, costs due to stealing and ethical issues, corruption, the cost of insurance, and the cost due to the breakdown of expensive items (Jensen and Meckling, 1976). Since the exact conduct of the agent cannot be measured, proxy measures are used to change that conduct (Mitnick, 1992).

The finance model states that one of the most important issues is the construction of incentives and rules in corporate governance. Practically, it is designed implicitly and explicitly to ensure synchronisation between the conduct and aims of managers and the

owners (Houston and James, 1995), but the need to implement a fixed set of rules and procedures to formalize the agent's conduct is in itself costly (Elsayed, 2007; Mitnick, 1998).

Originally, the principal-agency theory was studied via mathematical models of the agency relationship whilst also relying on assumptions, econometrics, and the non-risk elements. These studies were able to successfully mathematically model relationships, but as noted by Jensen (1993, p. 333), "[a]uthor are led to assume the problem away or to define sterile 'toy' problems that are mathematically tractable".

However, when it was noticed that this approach did not incorporate the real time issues, a new school of thought emerged which included the four important factors of political science, expert agency, the law of agency and sociology (Roe, 2000), and culminated in the Positivist Agency Theory, which focuses on finding answers to the issues of agency for both corporate and government sector. This new theory has spread and been accepted worldwide since its inception in the 1980s and is now used to understand the various level relations between the principal and agent and not just owner and management (Shapiro, 2005).

In the particular situation of banking, Hawley and Williams (1996) used positivist agency theory to explain managerial performance, and obtain a more comprehensive perspective of the relationships among the concerned parties. Such knowledge is essential to achieve good corporate governance, because with that organizations can adopt methods, including boards of directors, auditors, and other stakeholders to ensure checks and balances on management. It is agreed that the weak monitoring of managers may encourage them to pursue their own interests by engaging in activities such as earnings management and other types of corporate fraud. Basically, agency theory lays the foundation for the governance of firms because, with more control and monitoring, managers tend to perform better regarding the wealth maximizing objectives of the firm, and are more likely to adopt various external and internal mechanisms to achieve this objective (Datta et al., 2001).

There is clearly a link between corporate governance and agency theory since the former spells out the roles and responsibilities of the different people in a firm, and rules and procedures, and by doing so provides the structures through which the corporation can set its aims and the means to attain those (Alexander and Dhumale, 2001). This clearly establishes the nexus between agency theory and corporate governance.

3.3 Stakeholder Theory

Stakeholder theory was deemed part of the management literature in 1970 and has undergone a gradual process of change, with a substantial contribution by Freeman (1984), with respect to the incorporation of corporate accountability into the roles of various stakeholder groups. The basis of stakeholder theory is a mixture of social and organizational disciplines.

Clarkson (1994) and Blair (1995) considered the firm as a basic structure intended to develop value and wealth for its stakeholders (individuals and groups within the wider society); and stakeholder theory addresses the concerns of stakeholders (Freeman, 1999), all of whom participate in a business and are affected by its activity (Donaldson and Preston 1995). The two main questions formulated by Freeman (1994) to articulate stakeholder theory were: (a) what precisely is the main aim of the company, and (b) what is the main responsibility of management towards its stakeholders.

This theory is perceived as an alternative to principal-agent theory and is based on the premise that corporations owe a responsibility to a wider range of stakeholders than simply the shareholders. That said, some of these stakeholders are also the shareholders as they provide the risk capital of the firm, and their goal is clearly to maximize their wealth. According to this theory, stakeholders include any individual or group who can affect or be affected by the actions of a corporation. These include, but are not limited to, customers, employees, creditors, suppliers, and the community. The theory asserts a mutual relationship in which the corporation affects all of its stakeholders who in turn affect the corporation (Psaros, 2008). Proponents of stakeholder theory argue that corporations must take account of stakeholders' interests when designing and implementing their strategy, bearing in mind their interdependent relationship with stakeholders. In a setting founded on the stakeholder theory, corporate governance is a fundamental strategy that helps corporations respond effectively and efficiently to the actions of their stakeholders.

A strong relational aspect is seen within stakeholder theory, in which networks are perceived as being in place for enhanced corporate performance, and to serve the company at large including its stakeholder groups (Freeman, 1999). Likewise, Sundaram and Inkpen (2004) stress the importance of stakeholder theory, asserting that it pays greater attention to the full range of stakeholder groups that previous theories ignored, and emphasises their relative significance in the minds of the managing team. Donaldson and Preston (1995), on the other hand, argue that virtually every stakeholder group involved in the activities of the business is the same, having the same objective, that being to reap profits, a perspective

supported by Clarkson (1995), who argues that the responsibility of the company is to make the most of the stakes provided in it by these individuals or groups. And Donaldson and Preston (1995) note that management must protect all stakeholder interests evenly, since none of them precedes or succeeds the other. They also note that stakeholder theory has increased in popularity due to the possibility that stakeholders potentially affect the performance of the company in a positive manner (Donaldson and Preston, 1995).

The emphasis on stakeholders is dependent on the extent of protectionism afforded to stakeholders. In this respect, La Porta et al (2002) assessed the theory in the context of different countries, finding that the value of the company is comparatively high in nations that have fair and strict standards of protectionism for minority shareholder groups. Moreover in those nations where minority shareholders are properly safeguarded and receive sufficient information upon which to base their investment decisions, there has been a growing trend of lack of investment in industries that are in decline, meaning that the investment of capital is not focused on how much money the shareholder can bring to the table but on the relevance of the industry and its future prospects. The yardstick pertaining to the framework of operational effectiveness and efficiency in relation to the proper management of stakeholder groups by companies takes into consideration that the identification and recognition of these stakeholder groups is via legislation.

Hill and Jones (1992) note the relationship between stakeholder groups and management agent, and Brummer (1991) highlights this as a consequence of the fact that both are subjected to a contract of an explicit or implicit nature. Moreover, the relations are further safeguarded by the overall framework of governance. Brummer (1991) also pinpointed several commonalities among the factors linked with agency theory, and those associated with stakeholder theory, suggesting that the relation pertaining to principal and the agency, in the context and specifications of the theory of agency, may be seen as a sub-group pertaining to the overall relation between stakeholders and the agency.

Turnbull (1994), however, argues that despite being applicable in the real world, there are a number of loopholes in the concept-led and empirical base that supports the phenomenon pertaining to the theory of stakeholder groups in the literary sense, and suggests that these conceptual flaws have negative effects. Indeed, Donaldson and Preston (1995) claim that the theory has little to do with the present-day capitalist environment, and that a structural change is required if the expectations and benefits offered to the stakeholder are actually to be realized in the future. Furthermore, since the conception of the theory itself is ambiguous, the subsequent conclusions of the theory and their validity are also in question.

The common criticism of the stakeholder theory is the difficulty associated with aligning the conflicting interests of the stakeholders, especially in the context of the banking sector. For instance, there cannot be any co-ordination among the deposit-holders of banks (Turnbull, 1994). It is also impractical to represent all stakeholders effectively in the corporate governance recommendations, as this is more likely to undermine the welfare of the company.

In the case of banks, the stakeholders are both numerous (depositors, debt holders, and the government as both insurer of deposits and residual claimant on systemic externalities) and large (over 90% of the balance sheet of banks is debt). However, only the shareholders (not the stakeholders) control the banking activities, which is the main source of potential conflict. Bank stakeholders have different objectives, with debt holders and regulators preferring low volatility and taking a longer-term view, while suppliers of goods or services want to be paid the full amount for their service. Providers of both the short-term and long-term capital expect to receive repayment of their investment along with interest; workers want to receive a reward in the form of salaries and other benefits for providing their skills and knowledge; the legal authorities create the enabling environment to conduct business, but expect taxes; bank clients expect quality products and services at an affordable price; and the local community is interested in the positive impact of the firm on natural and social environment in which it is located (Mehran, 2011).

Equally, as financial intermediaries, banks can significantly affect their stakeholders. The activities performed by banks in the financial markets, such as extension of loans, play a significant role in influencing interest rates, prices of assets, and the level of uncertainty in the market (Andries, 2009). Moreover, by providing credit to customers, banks enable them (customers) to access the funds required to finance their investments. However, when banks increase interest rates or are unable to perform their role efficiently due to poor corporate governance, investment and the economy are likely to slow down (Mehta, 2000; Sergent, 2001). Similarly, banks may be affected by the actions taken by savers (depositors and bondholders). Generally, savers and the public in general provide liquidity to banks. In the event that they lose faith in a bank as in the case of the Northern Rock Bank, they are likely to withdraw their funds from it or refrain from using the services it provides. This may in turn cause the bank to lose its liquidity or become susceptible to liquidity risk (Hart and Tindall, 2009; Ruozi and Ferrari, 2012).

Here it is also worth noticing that corporate governance mechanisms that protect the interests of shareholders may not necessarily benefit creditors. The crucial problem may arise around capital structure, especially debt. On the other hand, excessive debt may lead

to under-investment, particularly in cases of financial distress, when a company is unable to undertake valuable projects, thus lowering their expected future cash flows. In contrast, highly leveraged firms may make excessively risk investments in order to increase both the mean and the variance of future cash flows. As a consequence, their creditors bear a significantly higher default risk than shareholders, who in case of a successful project, benefit considerable more than creditors.

Conflict between shareholders and stakeholders may have implications for banks' (internal and external) systems of corporate governance. The existing body of literature suggests several differing techniques that can be used by shareholders to reduce the agency problem and enhance shareholder value creation, one being compliance with corporate governance best practice codes like for example: limiting the number of external boards on which a director can serve, so that s/he is able to exercise effective control over the day-to-day operations of a given firm; separation of the roles of chairman of the board and CEO, in order to ensure that board preserves the interest of shareholders not managers; establishing independent board auditing committees to increase transparency; active exercise of voting rights by minority shareholders, in order to ensure diversity of opinions and interests; gender equity among board members, in order to ensure a wider spectrum of approaches and values. On the other hand, different stakeholders may influence corporate governance mechanisms through, for example: increased employee demands for improved transparency, management, rights and representation in decision-bodies; the shaping of the legal environment by regulatory authorities; customers' change of financial service providers.

Both firm and market-level corporate governance mechanisms can provide a suitable framework for ensuring that the interests and concerns of stakeholders are addressed appropriately. At this point it is worth summarizing how market-level and bank (firm)-level corporate governance mechanisms have been designed to take account of the interests of various stakeholders. The comparison of both systems and their possible impact on various stakeholders is presented in Table 1.

Table 3.1: Attributes of Bank Oriented and Market Oriented Corporate Governance System and its Impact on Stakeholders

Attribute	Bank (firm) oriented corporate governance system	Market oriented corporate governance system	Potential influence on various stakeholders
Board composition	Diversified (encompass various stakeholders)	Not diversified (weak representation of different stakeholders)	<ul style="list-style-type: none"> • The representation of diverse stakeholders in the board of the corporation legitimise and safeguard the interests of stakeholders and ensure that their concerns are adequately addressed in the decision-making process (Ayuso and Argandoña, 2007) • The presence of stakeholders as directors and their appointment in oversight or monitoring board committees, such as audit and nominating committees, play a critical role in ensuring that stakeholders are to some extent involved in the direction and control of the firm and their interests are taken into account (Ayuso & Argandoña 2007, Luoma & Goodstein, 1999).
Stock concentration	High	Low	<ul style="list-style-type: none"> • Ambiguous – less diversified owners may positively (Gorton and Schmid, 2000) or negatively (Demsetz and Villalonga, 2001) influence company’s performance.
Number of institutional holdings	Low	High	<ul style="list-style-type: none"> • Ambiguous – both situations may positively and negatively influence bank performance
Character of monitoring	Internal	External	<ul style="list-style-type: none"> • Both approaches may have a positive influence (Malaescu and Sutton, 2015)
Shareholder value maximization	not a priority	Priority	<ul style="list-style-type: none"> • Priority of shareholder value maximization may have a positive influence if it is exercised in long term strategy.

At the market level, corporate governance is expansive and generally entails regulating and supervising all banks and non-bank financial institutions in the market with the aim of protecting consumers, promoting healthy competition among financial service providers and ensuring that the industry remains stable. On the other hand, at the firm level, corporate

governance touches on the mechanisms put in place in a particular corporation or firm to control, direct, monitor and supervise the actions of the management in order to create long-term value to the firm and its shareholders (Du et al., 2010; Wall, 2010).

The Anglo-Saxon corporate governance applied in the UK banking system, is typically characterised by widely dispersed stock ownership and a strong focus on shareholder interests. In this approach the main source of capital is the financial market, which is a result of the relaxation or even lack of capital flow regulation (Hall and Soskice, 2001). Historically, the UK banks' approach to financial supervision has been informal (Goodhart, 2004), as regulation authorities place great trust in the industry itself. The system seemed to work well until the 1970s when, after a significant number of hostile takeovers which reorganised British industry, there was increased awareness of the financial benefits of investments undertaken through leveraged finance. This encouraged 'short-termism' and speculation as both bankers and shareholders became highly impatient for a quick and high return on their investments. Since then the equities have become "gambling chips" (Konzelmann et al., 2012). Resulting from the property bubble, cheap debt and excessive leverage triggered significant economic crises. Following that crisis, the 1979 Banking Act gave the Bank legal powers to support its supervisory authority, and a two-tier system dividing banks into the categories of 'recognised banks' and 'licensed institutions' was created. For the first time, a legal framework to protect small depositors in the event of a bank bankruptcy was implemented as the 1986 Financial Services Act changed the role and functioning of banks and launched stronger investor protection. Initially, governmental institutions principally to supervise various self-regulatory organisations (i.e. The Securities and Investments Board – SIB in year 1986) were established. Secondly, the Financial Services Authority was created in the 2000 by the Financial Services and Markets Act as a single, private, limited by guarantee, unified regulator for financial services (Goodhart, 2004), without any operational or financial control from The Treasury. Since the sub-prime mortgage crisis and the following credit crunch, which burst in the first decade of the 20th century, banks have come under increasing pressure, to take a more long-term view of their investors' business interests and to acknowledge and respond to their obligations to society (Grove et al., 2011). Post-crises Basel, UK and EU banking regulation directly encompass a stakeholder approach. For example, new Basel III regulations (specifically a core metric called the risk-based capital ratio) are perceived as a strong market force, which will create a demand for banks to adopt corporate governance measures and abandon pro-management decision-making. This new capital requirement of Basel III aims to discourage short-term risky behaviour of the executive. Another rule which encompasses the reformulation of the calculation of risk-weighted assets, aims at strengthening current regulatory oversight of financial institutions and discouraging banks from using off-balance sheet vehicles to

obfuscate the true size of the bank's exposure to risk. A main objective of the Basel III standards is to improve transparency of the capital base. This transparency is supposed to be strengthened by new disclosure requirements which are designed to provide all stakeholders with an accurate picture of financial statements, proscribed capital reserves and leverage ratios. Undoubtedly the above principles of Basel III are not only reforming corporate governance of banks, but also reducing agency costs by discouraging executives to undertake short-term high-profit and high-risk decisions. These regulations are also designed to protect consumers, borrowers, and other stakeholders from another severe financial catastrophe (Howard, 2014b). In terms of mitigating exploitation of stakeholders by financial institutions, European jurisdictions provide public authorities with the power to reorganise the debt position of systematically important financial firms (credit institutions, investment firms and insurance companies) who face the necessity of bailouts. The UK Banking Act 2009 provides for three bank resolution regimes: a stabilisation option, an insolvency procedure, and an administration procedure. The first regime enables transfer options to a private sector purchaser, a 'bridge bank' or to temporary public ownership. The second procedure allows the bank liquidator to arrange for the bank's eligible depositors to have their accounts transferred or to receive their compensation from the Financial Services Compensation Scheme (which is the UK implementation of the European Jurisdiction Depository Guarantee Scheme). The third regime enables the court-appointed bank administrator to ensure that the residual bank can operate effectively as a private sector purchaser or the bridge bank (Arons, 2014).

This legal framework directly affects the role and power of UK banks' stakeholders. Under UK Company Law, equity owners can appoint and dismiss directors, and less than 10% of a firm's shareholders can call an extraordinary general meeting. Apart from the above, anti-takeover measures are effectively outlawed by the UK legal system, and thus they are not a key issue in corporate governance of UK firms. The UK legal framework also sets strict requirements on the provision of information provided by publicly listed firms to shareholders. It also provides arrangements for voting on resolutions. Failure of this corporate governance framework can result from two potential agency problems: lack of voting rights expertise among shareholders, and the appearance of additional agency conflict between institutional investors and their clients. Both problems have been addressed by various legal rules and recommendations (see Mizuno and Tabner, 2009, for a detailed overview of the law).

According to the traditional view, corporate governance principles and mechanisms are supposed to reduce agency cost by giving stakeholders some control over corporate decision makers (Goforth, 1994). However, some recent opinions of academics and

policymakers are that stakeholders should be excluded from the corporate governance discussion (Howard, 2014a). The stakeholder theory has been criticised for being idealistic and impractical mainly because it asserts that corporations have to be accountable to a wide range of stakeholders including the society in which they operate. To some extent, this assertion goes against the goals and objectives of many corporations which seek to create value for their shareholders. Furthermore, Solomon (2007) notes that, according to corporate law, the key fiduciary and legal obligation of corporations is the maximization of its shareholders' wealth. Creating value or wealth for shareholders, while simultaneously trying to meet and balance the needs of a broad range of stakeholders, presents a major challenge for many stakeholders. Another major problem with the stakeholder theory lies in identifying who are the stakeholders. The term stakeholder is wide ranging and may constitute of many people that a corporation may not be in a capacity to deal with or relate to (Fernando, 2009, Solomon, 2007). Finally, it is worth mentioning that in the Anglo-Saxon system applied in UK banking sector, regulators place the responsibility for creating a dynamic and innovative marketplace with politicians. In this approach the financial market is expected to be highly diversified with highly internationalised players and access to global capital. As a result, individual and institutional investors require the ability to span jurisdictions, arbitrate regulatory systems, and be highly mobile. Thus, even 'light touch' regulation may be unwelcome, as it may increase the risk of instability (Konzelmann et al., 2012).

The strong criticism of stakeholder theory is that it is incompatible with the fundamental organizational objectives and, therefore, will be unable to provide better corporate governance (Deegan and Blomquist, 2006). It is argued that unlike in stewardship theory, it is likely to be impossible to balance stakeholder interests using this theory. However, the moral perspective of stakeholder theory places all stakeholder groups equal and their treatment is thus, fair. Managers are expected to maintain the business of the firm while putting the interests of all concerned stakeholder groups in mind, irrespective of whether this concern actually leads to enhanced performance on a finance-related front (Deegan and Blomquist, 2006). Hence, stakeholder theory in combination with agency theory is a sound proposition for the present study, especially because the former has several useful aspects which make it particularly suitable. The first is that it attempts to describe, prescribe, and derive various alternatives for corporate governance that include and balance a multitude of interests. It incorporates an executive power model, and subsequently suggests that the main reason why a firm exists is the maximization of its wealth; this actually includes the wealth of all of its stakeholders. The second factor is that, according to Donaldson and Preston (1995), the stakeholder theory proceeds along several lines; first, the instrumental stakeholder theory assumes that, for managers to maximize the objective functions of their

firms, the stakeholders' interests should be an underpinning objective in that very same pursuit. Next, the theory brings out the interaction between the firm, managers, and stakeholders, and further prescribes what the managers need to do to satisfy the expectations of all of the parties involved. As Elias and Cavana (2003) indicate, another interesting characteristic of the stakeholder concept is the dynamics of the stakeholders. This theory considers the important fact that the mix of stakeholders may change from time to time, thus affecting the corporate strategy of a firm.

Another important reason for the adoption of the stakeholder theory in this study is its special consideration of ethical principles (Phillips, 2003). It is evident in the corporate management models originating from this theory that unethical behaviour benefits the management rather than stakeholders, and this is a factor that challenges the very basis of the theory. However, corporate management as a whole largely depends on practices that are desirable and acceptable by all parties in a firm and thus it is in the interests of all stakeholders that a corporation follows ethical codes with regard to how the company is run in order to realize the corporate goals. It is, therefore, quite clear that the main purpose served by the stakeholder theory is to help boards of directors and managing groups to understand the environments within which their stakeholders operate, and manage more effectively considering the relationships existing in their companies. The stakeholder theory also assists corporation directors and managers to improve the value of the consequences of their actions, and also minimize the risks to stakeholders.

3.4 Stewardship Theory

Stewardship Theory has sociological and psychological roots. Davis et al. (1997:25) claimed "A steward protects and maximizes shareholders' wealth through firm performance, because by doing so, the steward's utility functions are maximized". Essentially, stewards are managers delegated by shareholders to conduct business on their behalf, ensuring that they protect and maximize the profit. They are considered successful if they work diligently to ensure the organization performs satisfactorily and generates returns for shareholders (Donaldson and Davis, 1991, 1994). Hence, Stewardship Theory focuses on the duties of stewards (higher management) and their aims, arguing that the steward's motivation is proportional to the firm's success. Stewardship Theory distinguishes structures that offer autonomy to the steward to facilitate his/her efforts to increase shareholder returns, and simultaneously reduce the costs of controlling and monitoring (Donaldson and Davis, 1991). Daily et al. (2003) make the observation that directors try to increase the financial returns for the shareholders in order to create their own reputation as effective business decision-makers.

Stewardship Theory also points to the benefits of combining the role of chairperson and CEO (Hendry, 2002), and other scholars comment on the board composition, and indeed question the necessity for a board. Donaldson and Davis (1991) noted that a board comprised of non-executive directors is unable to operate efficiently, and exercise control; and Hawley and Williams (1996) suggested that it would be logical to function without a board of directors and to work instead with a board dominated by executives. Similarly, Mehran (1995) commented on a Canadian enterprise with a reputation as a staunch business leader, which had removed the board and replaced it with a body of advisors, a practice advocated for all organizations as a means of preventing corporate scandals.

In this regard, Tricker (1996) suggested that the central ideology of directors being entrusted with a fiduciary role requires such individuals to be trustworthy and act in the best interests of the firm. Such expectations are enshrined in Anglo-Saxon Law, which grounds the responsibilities and obligations of the director in Stewardship Theory. This responsibility is much greater than that associated with a mere agent, since the steward is considered to act as the company itself rather than simply representing it (Hawley and Williams, 1996). Scholars comparing Stewardship Theory with Agency Theory (see Walton, 1985 as an example) argue that although being instrumental in their own respect, these theories tend to contradict each other, implying that companies must decide to adopt one method over another. However, this opinion is criticized by Donaldson and Davis (1991). Indeed, the argument of incompatibility fails to consider the effect of operating within a regulated industry (Pfeffer, 1972), or of having a strong, dictating shareholder with enough power and influence over the board, management and company in general, to be able to function in a supervisor-like capacity in terms of matters of the board or even as a 'relationship investor'. Certainly, this is quite common practice in Anglo cultures, and in some regions it is actually expected due to the enforcement of law (Analytica, 1992).

Ghoshal and Moran (1996) argue that the opportunistic behaviour recognized in Agency Theory is unavoidable, and Tricker (1994) notes that the imposition of tougher and relatively elaborated sanctions and incentives further fuels such behaviour. Likewise, within Stewardship Theory there is also the potential for opportunism, especially in companies with no independent directors (Turnbull, 1995d). Furthermore, as Turnbull (1995a) observes, the inclination to act as a steward or agent is more likely to depend upon the type of institution, and other relevant factors, thereby suggesting that neither theory can be seen as contradictory in nature, and that both may be deemed to be ingrained in political frameworks, or other wider structures for corporate governance.

Wearing (1973) has argued that individual differences are extremely relevant in determining the felt need for monetary benefits and acceptance, and that people may oscillate between competitive and collaborative behaviour, typically being seen as assuming both strategies simultaneously.

However, this research proposes to adopt the philosophy underlying the stewardship theory (Turnbull, 1995b). With respect to the aforementioned theory, resulting behaviour that dictates the actions of the steward is collective and, therefore, stewardship maintains that the optimum governance structures are those that enable coordination in the enterprise. It is well established that corporate governance practices in a corporate setup cannot be individual-based Ghosal and Moran (1996). The implementation of solid corporate governance practices requires the contribution of the organizational members at all levels. This in turn implies that there must be effective coordination of the organizational activities to achieve the organization's goals (Turnbull, 1995c). The stewardship perspective sees the directors as well as managers as stewards of the firm and the alignment of interests and benefits pertaining to the directors and managers with the interests of the owners of the firms (Hawley and Williams, 1996). This underlying philosophy of stewardship theory appears to have a closer link to corporate governance concept than philosophies underlying the other theories discussed herein.

According to stewardship theory, corporate governance may be dependent on the idea that it is the directors that are in charge of safeguarding corporate assets, on behalf of different stakeholders, without any conflict of interest or opportunistic behaviour at the expense of stakeholders (Pagano and Volpin, 2001a). The theory further assumes that the amount of control offered and enjoyed by the company managers enables them to maximize the overall performance of the firm, thus increasing its overall profitability. This assumption in the stewardship perspective provides theoretical support for corporate governance. Therefore it is quite arguable that when responsibility and authority of the executive managers increases the focus on achieving the company's objectives, leadership and effective implementation of operational decisions (Lawler, 1986). These are the essential pre-requisites for implementing effective corporate governance practices in any corporation.

Although the stewardship theory asserts that corporate governance seemingly depends on the view that on behalf of the stakeholders the directors safeguard the corporate assets without any conflict of interest or opportunistic behaviour at the cost of stakeholder-groups (Jensen and Meckling, 2006), in practice however, it is not always the case. Competing interests make it almost impossible for directors to act purely as stewards. The main reason why this thesis will not adopt the stewardship theory is that, although it offers a lot of valid

points regarding the moral duty and functions of the directors or managers in acting as stewards for a firm without vested interests that put those of investors in jeopardy, manager will not always act to set their personal interests in line with those of the shareholders. However, this potential risk of managers acting in their personal interest cannot be eliminated from consideration under agency theory. Compared to other theoretical perspectives, the stewardship theory seems to have a greater leaning towards effective corporate governance. Under the stewardship theory, it is automatically assumed that managers are quite like a faithful steward of the company. Moreover, still working within the confines of the stewardship theory, the dictating factor of corporate governance is that the individuals working on behalf of the company's management are keen to do a good job on behalf of the shareholders (Eisenhardt, 1989). This implies that the managers want to be respectable stewards with respect to the assets of the company and are unwilling to disengage from the interests of the company and other stakeholder parties. They also do not want to benefit on a personal level be it monetary or non-monetary in nature at the cost of the shareholders. The directors appointed by the members at a general meeting exercise the power of the firm and are accountable to the shareholders for their actions. The external and independent auditor checks the authenticity of the accounts and financial statements and certifies them as representing a consistent and correct assessment of the financial status of the firm (Padilla, 2002). In fact, the stewardship theory is considered as the forerunner to many regulations and legislations; this study corroborates this assumption. However, the study does not consider the adoption of stewardship as one of the underlying theories of the research because of its underlying weakness regarding the view that directors or managers are supposed to be completely neutral and act in the interests of investors. In fact, one factor that motivates most people to take management or executive positions is the benefits they hope to achieve in the process and thus, in modern business, it is almost impossible to find a firm where the leadership is purely acting as a steward (Benston, 2005). Thus, the other theories, especially the agency theory, are more appropriate for outlining the current corporate management environment although it can borrow a lot from aspects of the stewardship theory. For this reason, stewardship theory will not be adopted for this thesis.

3.5 Resource Dependency Theory

Resource Dependency Theory focuses on the relationship between the firm and its environment, especially the one outside the firm's internal dynamics, from which it requires resources in order to add value to it as an institution. The theory acknowledges that no organization can be completely reliant on itself in an operating capacity and must look to the external environment to provide input one way or another (Aldrich, 1999). Without such

input, companies may not achieve their stated goals, and may even find their existence threatened (Scott, 1998). However, the external environment is an uncertain one, and Resource Dependency Theory recognizes the need for the management team to manage its dependency effectively. An organization is deemed to be operating successfully if it is able to increase its power and influence while bargaining with its environmental uncertainties (Allaire and Firsirotu, 1989). This can be done by implementing either an adapt-first strategy or by avoiding being subjected to demands from the outside environment by introducing counter-strategies pertaining to the theory of dependence in motion (Grewal and Harwadkar, 2002). Such strategies involve “altering organizational interdependence” either by integrating, merging or diversifying operations; establishing a range of co-operative structures in the formation of a relatively “negotiated environment”; and using aspects of the legal structure, political environment or social mechanisms to form a relatively “created environment” (Pfeffer and Salancik, 1978). Emerson’s (1962) earlier work identifying many of the resource dependency theory strategies, also advised that the firm’s corporate strategy should address its relationship with the external environment. Implicit in this idea is that a relatively effective and well-managed labour market wherein the relevant skills are both available and competitively accessible, does in fact exist. Hence, this theoretical model is strongly contingent on the presence of a competitive environment.

Proponents of the theory believe that organizations should continually be working to control relevant resources for them to be effective (Hillman et al., 2000), such that their dependencies are properly managed and uncertainties within their environments do not function to jeopardise their financial stability (Singh and Davidson, 2003). Hence, the basis for strategic decision-making should always be a consideration of which strategy will influence and control the external context such that it becomes advantageous to the firm (Geyskens et al., 2006). Essentially, the theory is about promoting self-interest in a competitive, brutal environment (Pfeffer and Salancik, 1978). Pfeffer and Salancik (2003:25) assert that “resource dependence was originally developed to provide an alternative perspective to economic theories of mergers and board interlocks, and to understand precisely the type of inter-organizational relations that have played such a large role in recent ‘market failures’”. In its original conception, the theory considered the brief of those left in charge of governing a company to keep it afloat during times of uncertainty, to increase their own autonomous capacity, and to stabilize the company’s exchange-dependent relationships (Rindfleisch and Heide, 1997). In fact, gaining influence has been considered more important than profit-making, negating the economic dimensions existing in present times (Phan and Yoshikawa, 2000).

This study adopts the resource dependency theory because it focuses on influence of boards of directors in acquiring important resources (Hillman et al., 2000) through their associations within the external environment. Furthermore, it is also stated that the availability of resources at the firm's disposal significantly alters its functionality, and hence, the profits it is able to generate and its ability to stay afloat (Daily et al., 2003). This potential to survive is an important consideration (Chin et al., 2004), neglected by much of the literature which typically focuses on issues related to enhancing productivity or profitability (Clark, 2004). However, the question of how organizations can survive remains under-explored, and as noted by Deegan (2006), continued existence may be difficult without the acquisition of the necessary resources for survival.

3.6 Transaction Cost Theory (TCT)

Transaction Cost Theory was originally proposed by Cyert and March (1963), but underwent a series of developments until it reached the stage of theoretical definition by Williamson (1996). Its underlying assumption is that the firm is comprised of individuals with varying viewpoints and interests. Additionally, it works from the premise that since corporations have grown in size and stature they have become able to act as an alternative to the market in determining how the resource pool is allocated (Abdullah and Valentine, 2009). It has also been argued that managers' motivation is more opportunistic, and hence managerial transactions may be arranged to satisfy self-interest (Williamson, 1996).

TCT has undergone certain developments relating to the "comparative costs of planning, adapting, and monitoring task completion under alternative governance structures" (Williamson, 1985:2). These costs are said to occur "when a good or service is transferred across a technologically separate interface" (Williamson, 1985:1), and can be affected by a total of two human-related elements coupled with three environment-dependent dimensions. The human-related elements are understood to be:

- Bounded rationality: the fact that humans will most likely not be able to acquire the resources or capabilities needed to give proper consideration to every single state-contingent result linked to any transaction that might occur.
- Opportunism: individuals can be counted on to act in their own self-interest first and foremost.

The three environment-related dimensions are:

- Uncertainty: this strengthens the negative problems stemming from opportunism and bounded rationality.
- Small numbers trading: if the market has only a small number of players within it, disciplining the parties involved will become difficult, and non-conformance will be encouraged.
- Asset specificity: asset values can be linked to the transactions in which they are involved. A party investing in any asset will suffer a great loss if another party that has not invested in that asset withdraws before completing the transaction. This possibility is known as the 'hold-up' problem (Williamson, 1985).

It is asserted by the TCT that the larger the number of parties to the transaction, the greater the costs associated with the process (Rindfleisch and Heide, 1997). However, the transactional element has been little researched as noted by Steenkamp et al. (2006), and hence, there is a need for more investigation of this, especially with the advent of modern electronic-based modes of partnerships emanating from the influx of IT (Chatterjee, 2006). Williamson (1985) suggested that generally, companies were more likely to internalize the transaction process with the increase in the number of transactions in which it was involved, but more recent opinion (see Watson et al., 2004) now favours outsourcing because the benefits of IT and real-time communications make such a strategy viable.

Therefore, given that banks are in the transaction business and that banking institutions are designed to minimize transaction costs, TCT can benefit the current study in explaining the nature of banks as corporations and their risk-taking positions in transactions (Chatterjee et al., 2006). This approach is extremely relevant in this age in which the risks are numerous, and depression can easily occur. Banks are institutions that should be approached from a transactional perspective that recognizes the interacting factors that influence the final product (Glassberg and Merhout, 2007).

The TCT tries to better describe the predominant reasons for companies' existence, expansion, and outsourcing of some of their activities to the external environment (Glassberg and Merhout, 2007). It assumes that one of the objectives of companies is to decrease the costs associated with the exchange of resources within an environmental context. It also assumes the minimization of a firm's administrative costs with respect to its internal environment. Consequently, firms are seen as considering the trade-off between the costs they are likely to incur in exchanging resources with the environment, and the

administrative costs, which they would incur if they decide to perform the activities in-house (Monks and Minnow, 1995).

The TCT views the institutions and the encompassing market as different agencies that might help them in organizing and co-ordinating economic transactions (Dow, 1987). When an organization finds external transactional expenses to be greater than those incurred by the internal administration of such transactions, it likely to grow and expand. This makes sense because the bigger the firm, the more reliant it would be on internal administrative procedures, which already cost less than the external transactional expenses, thereby making it more profitable overall (Williamson, 1981). However, when the administrative costs involved in co-ordinating the activities are higher than the external transaction costs, the company may decide to downsize to reduce them (Williamson, 1979). This equation implies that all companies will expand their activities provided that they are able to perform them more cheaply within the company than it would cost to employ external service providers available in the market.

According to TCT, transaction costs are incurred by the company in each instant that a good or service moves from one stage to another (Macher and Richman, 2008). Hence, it may be necessary to introduce a more pronounced range of technological capabilities in each stage to produce the transaction, which again increases transactional expenses.

Several factors impact upon the transaction-related expenses pertaining to the give-and-take of resources within the environmental context. These include the insecurity caused by an uncertain environment, opportunistic and self-serving behaviour, risk factors, myopic thinking, and finally, the firm's core assets. All of these factors are quite likely to increase the external transaction costs (Williamson, 2005). In controlling for these factors, transactions become more costly. Therefore, with a highly uncertain external environment, a company may choose not to outsource any activity or exchange its resources with external agencies (Williamson, 2002). In terms of its relationship with corporate governance, the TCT seems to be irrelevant, and consequently, as a theory, it is of little interest to this study.

3.7 Political Theory

In the political model, corporate power, allocating profit to owners and privilege to stakeholders and managers, is mainly guided by government favouritism towards some constituencies; and shareholders' capabilities depend on a macro framework that influences the allocations in the firm. The political model is seen to have greatly influenced the development of corporate governance (Hawley and Williams, 1996), as the behaviour of the

shareholders substantially affects company decisions. However, firms themselves have also actively contributed towards moulding the regulatory and political system in the US as observed by Roe (1994) who charted the evolution of the political model and its association with corporate governance. In doing this, Roe (1994) argued that seemingly decentralized and federal systems act as dictators on market-related dynamics, thereby affecting how firms are ultimately controlled. Gourevitch (2003), however, identifies many other factors prompting the evolution of corporate governance.

Essentially, political theory proposes that individuals work according to their shareholder status, and not on the basis of buying influence. Such shareholder efforts can have a pronounced impact on the prevailing corporate governance structures within a company. However, as noted by Pound (1993), when there is a national regulatory system, public interest in corporate governance is limited.

The political model accommodates issues of power given to firms, and the regulations on profit-taking and the allowance of perks (Black et al., 1990). Its emphasis on how corporations are governed acknowledges that such structures may also significantly impact on the way in which that governance is developed. Clearly governing authorities have a big influence on how companies are operated, and hence on their continued existence (Hawley and Williams, 1996). However, it is necessary as noted by Gundfest (1993), to understand the political marketplace to be able to engage in such analysis. Hawley and Williams (1996:32) make the point that:-

“[t]he political model of corporate governance (whether Pound’s or Gundfest’s version) places severe limits on the traditional economic analysis of the corporate governance problem, and locates the performance-governance issue squarely in a broader political context. Political does not mean necessarily imply a government role merely that it is non-market”.

This demands more research from an economic perspective pertaining to how transactions of an economic nature and corporate governance go hand in hand. Roe (2001) points to the need to assess the competitiveness of the marketplace since this dictates the amount of appropriable rents. It can be argued from this fact that social democracy has a higher probability of existing in small economies bearing a less competitive culture. Irrespective of which factor is dominant – the political or the economic – there would be a subsequent rise in agency costs since the management would be bound by fewer checks and enjoy their freedom while other stakeholders like the workforce may be more motivated to pursue rents

(Kelso and Hetter. 1986). Furthermore,

“due to the electoral importance of employees as compared to shareholders, this situation would usually result, at the national level, in the domination of the social democratic parties. In this scenario, the protection of the shareholders’ interests that is not ensured through the political or legislative paths would be carried out privately by the concentration of ownership” (Charreaux, 2004:25).

The political theory relies on the structural dimensions of the industry in order to understand the mechanisms governing the systems for corporate governance along with political positioning (Turnbull, 1988). Moreover, the existence in the more developed economies/countries of structures to safeguard the interests of employees, and concentrated ownership within the marketplace support this framework (Roe, 2001).

Roe (2001) affirms the dominance of politics over legality, and seemingly criticizes the theory of law and finance. In a subsequent study in 2003, Roe points to the restrictive nature of the legal system’s explanatory power, identifying two divisions within managerial agency costs. These are costs associated with: (a) the benefits of a private nature, which managers aim to obtain through opportunistic practices; and (b) errors stemming from managerial tasks seen in the exploitation of opportunities for investments, which are heralded as being in the best interests of the shareholders. Such ‘errors’ when made, are perceived as correct decisions by the managers and/or employees involved (Turnbull, 1988).

In the first case, the legal system can minimize the occurrence of such behaviour (Roe, 2002). In the second, the concentration of ownership can minimize managerial errors (Naciri, 2008).

Gourevitch (2003) identifies three 3 criticisms of the theory of law and finance, these being: the importance of legal protection for investors in financial dealings (Turnbull, 1991), the assumption that the law has very little to do with the determination of legal protection, and the fact that if corporate governance is determined by competition, then it will be attributed to political factors which thus become the primary explanatory variable (Gourevitch, 2003).

The models proposed by Pagano and Volpin (2001b), and Rajan and Zingales (2003) manifest these scenarios, suggesting that the principal explanatory factor for fiscal development lies within power which rests in forces of a political nature, which prove themselves to be of benefit.

for the following reasons: (1) the restriction on growth opportunities also limits the advantages; (b) finance can be arranged easily via a bank because of its ability to make use of collateral from different projects, and its reputation in the context of borrowing; and (c) the bank’s prowess effectively protects investments. Regarding financial interests,

development is comprised of comparative advantage, which is founded on the relational aspects of financing (Rajan and Zingales, 2003).

Naciri (2008) further notes the importance of political institutions in the aggregation of preferences (electoral laws, the degree of federalism, and the relationships between the legislative, executive, and party systems).

The fundamental assumption of political theory is that the financial model relies almost entirely on the market as controller of the firm, due to the emergence of political factors pertaining to decentralization and the advocacy of federal principles (Hollingsworth and Lindberg, 1985). Depending on the corporate governance mechanism, the principles and practices related to the constructs of political theory might support a phenomenon like the method entailing the development of the voting system that is more reliant on supporting the interests of the shareholding group instead of the individuals who bought their way in to influence the business of the company. Therefore, using the aforementioned theory to define and implement corporate governance in companies might vitiate the very objective of having a corporate governance mechanism implemented within the organization (Suchman, 1995).

Because of the assumption relating to the means by which influence and power are used to affect the direction of the firm, profit-making, and other perks (Turnbull, 1991), this theory conflicts with the normal corporate governance principles (Roe, 1994), and hence it is not employed in this study. Indeed, its emphasis on political inclinations, interest groups, and the role of political institutions, makes it a complex model, the constructs of which are beyond the scope of the current study.

3.8 Legitimacy Theory

Legitimacy theory embodies the idea that firms are evaluated within the public domain according to their suitability and desirability (Zimmerman and Zeitz, 2001) as perceived by the collective view of the external environment. It acknowledges the modern-day fact that the masses are more aware of how firms conduct themselves and expect them to be responsible entities rather than machines that merely earn profits to ensure their right to existence. However, even half a century ago, Dowling and Pfeffer (1975:122) noted that organizations “seek to establish congruence between the social values associated with or implied by their activities and the norms of acceptable behaviour in the larger social system of which they are a part”, and that company operations needed to be considered as legitimate by all their stakeholder groups (Pfeffer, 1981).

Firms are indeed, attuned to the need for a positive image, and strive to earn their profits in a manner that is acceptable to society at large. Certainly, advanced IT and globalization have made worldwide communication possible, such that a company's underlying image is not limited to its immediate surroundings. Hence, organizations wish to be seen to be behaving ethically and appropriately, and work to create a positive self-image to the public and specifically, their shareholders (Deegan and Bloomquist, 2006; Suchman, 1995).

The Legitimacy model theorizes that the firm, its efforts to manage individuals, its performance measures, and the reputation it gains within society, are inter-reliant components of a much larger culture-specific system. Suchman (1995) identifies three characteristics of legitimacy. Firstly it is generalized, highlighting greater examination than is associated with particular adverse occurrences and/or acts, and hence, cannot be expressed in solid concrete terms. Secondly, it is what is assumed by observers of the organization (the image held); and thirdly, it is built through a collection of social beliefs reflecting "congruence between the behaviours of the legitimated entity and the shared (or assumedly shared) beliefs of some social group" (Suchman, 1995:547). The last two characteristics are more socially dependent than the first, and hence involve relation building as a key factor. Figure 3.1 presents the different layers of Legitimacy Theory as depicted by Kaplan and Ruland (1991).

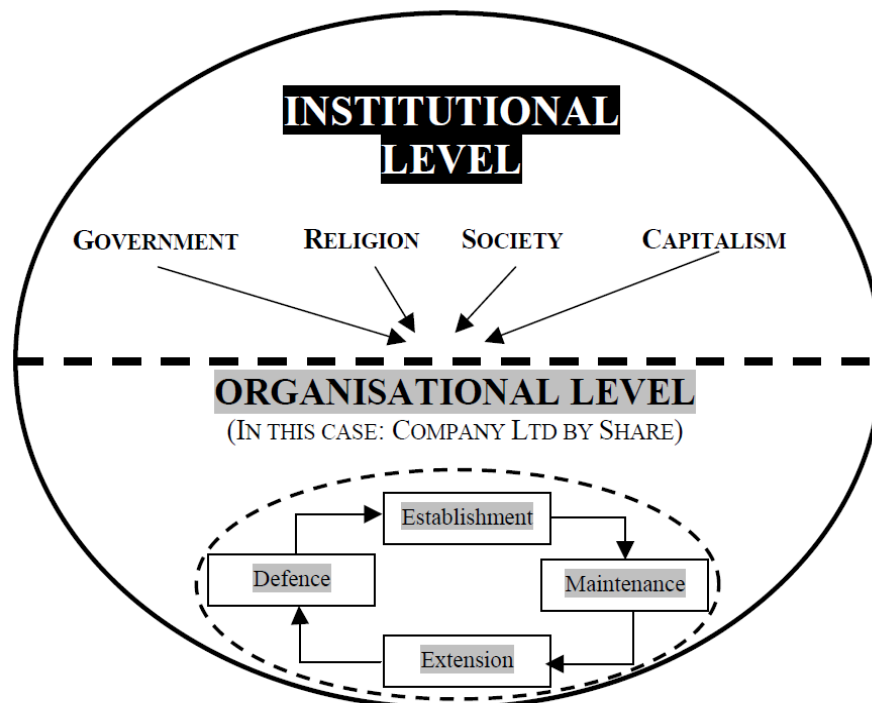


Figure 3.1: Multiple Layers of Legitimacy Theory

Source: Kaplan and Ruland (1991:370)

Sethi (1978) identifies a 'legitimacy gap', emerging when the firm does not act in an expected manner. Such actions can be heavily influenced by stakeholders (Wilmshurt and Frost (2000), who observe that 'acceptable behaviour' is actually established and updated by the various stakeholder groups, the company being merely a follower. However, only if it is able to follow appropriate organizational structures and practices in line with the pattern underlined by the stakeholders, is it considered as a legitimate entity (Meyer and Rowan, 1977). With such legitimacy, stakeholder groups are willing to trust the company to make the right decisions (Elsbach and Sutton, 1992).

The Legitimacy theory suggests that if a company is criticized for socially unacceptable behaviour, it begins to take measures to restore its legitimacy and increase its desirability from the stakeholder perspective (Suchman 1995). Such measures could include changing its offending operations, attempting to change the perception of the critics, and/or linking itself with a positive image – more in line with CSR activities (Dowling and Pfeffer, 1975).

It is clear that Legitimacy theory focuses on the conduct of corporate activities purely from a social perspective (Lindblom, 1994). However, this implies corporate governance practices that are neither rule- nor principle-based (Tilling, 2004), and in the case of banking this is not a sensible theoretical underpinning. Hence, it is not employed in the present study.

3.9 Summary

Summarizing, the respective theories seek to understand the motivation of the shareholder-groups, thus suggesting their priority as being to secure a healthy return on their investment. Regarding greater awareness levels of the environmental factors influencing firm operations, the overall magnitude of firm-specific operations should be considered using elements that have their basis in other than strict monetary terms like the impact of the legislature, along with various other social and cultural dimensions (Ching et al., 2006). Over time, as the environment and the firm evolve into much more complex beings, so too does the matter of corporate governance. The dominating factor from the internal environment is the shared interest in earning more profits and maintaining trust and harmony to ensure the realization of these collective interests (Deegan et al., 2000); whereas the external environment exerts pressure through globalization, and joint ventures, for instance (Clark, 2004). Furthermore, the manner and influence of corporate governance changes with respect to various factors like differences in the social and regulatory environment (Tilling, 2004).

It is difficult to determine the impact of corporate governance using one single theory, and more useful to consider several relevant conceptual underpinnings which together allow for the consideration of varying contextual factors (social, regulatory, legal, etc.). Indeed, any study should extend beyond the viewpoints expressed in already available literature (Ashford and Gibbs, 1990). Clearly, despite the presence of strong regulatory elements, breaches of corporate governance have still occurred, and hence, it is even more important to establish a more complete understanding of the factors precipitating such breaches, and how to avoid their recurrence. Given the appropriateness of each of the theories reviewed, this study chooses to use agency theory and stakeholder theory since in combination they offer the unified approach advocated by Hills and Jones (1992). In addition to the stakeholder-agency theory, however, the study also utilizes stewardship theory because of the theoretical support it lends to corporate governance mechanisms, especially relating to the safety of corporate assets.

3.10 Conclusion

This chapter has explored several theories relating to the corporate governance of firms operating in a market environment, with the aim of identifying the full range of variables that influence corporate governance structures and their appropriateness for any given situation. It has confirmed that the key objective of corporate governance mechanisms is not only to enhance firm performance but also to resolve any agency problems, by overseeing managements' actions and activities. Hence, all corporate governance frameworks are expected to facilitate reductions in agent-related costs, and protect shareholder wealth. Monitoring management behaviour is an implicit component of such frameworks (Hope and Thomas, 2008). Generally, corporate governance practices include structuring an effective board with well-organized sub-committees, creating well-designed remuneration arrangements that provide agents with incentives to act in the best interests of the shareholder groups, ensuring concentrated ownership that monitors and disciplines top management, and provides an effective external market mechanism that works in the absence of the effective internal control due to self-interested management (Clarke, 2007). Mallin (2006) concludes that the agency perspective is the most suitable approach of all theories, as it provides the most fitting understanding of the present corporate governance practices in the context of the UK. This review supports this finding, revealing agency theory to be superior for exploring the interpretation of, and suggesting solutions to the relationship between management and shareholders. Hence, this study adopts this theory as the basic theoretical background to clarify the relation entailing the corporate governance mechanisms and corporate performance along with risk management. It does, however, also employ stakeholder theory since this allows for an understanding of the ways in which

corporations operate, and helps to predict organizational behaviour. Its fundamental difference from other theories, is its intention both to clarify and direct the structural and operational matters that determine the existence of the company, and from this, the theory depicts the firm as an organizational entity that enables different parties to achieve various (possibly incongruent) goals (Lemmon and Lins, 2003). The stakeholder theory may be applied in many distinct ways involving the use of different methodologies. It can be descriptive and empirical in the sense that it can explain specific corporate characteristics and behaviour, and can also be instrumental when coupled with descriptive or empirical data. This instrumental nature can be utilized as a yardstick for the identification of the underlying link between stakeholder-management and the realization of expected firm-specific objectives. Hence, its descriptive, empirical, and instrumental characteristics make it a good theory to use in combination with agency theory, and in such a combination it has been used by Hill and Jones (1992) to consider the role of management as agent to the various stakeholder groups within a company. The theory notes the existing differences with respect to various stakeholder groups, differences of opinion concerning the importance of their stakes, and the amount of influence they can exert on the management. It postulates that because of the potential disagreements existing within the stakeholder-agent negotiation process, it cannot be assumed that the stakeholder-agent relationships always follow the 50/50 rule, as in equal safety of interests at all times. In the view of Hill and Jones (1992), those factors affecting the stakeholder-agent relationship should be the prime focus of analysis. Such factors form the underlying theoretical basis of the different corporate governance mechanisms (e.g. board structure and membership, board committees, and ownership structure). This theory is also considered an important element of the positive accounting theory, requiring descriptive research. Positive accounting theory is regarded as a neo-empirical research method because of its reliance on empiricism to establish theory from best practices. It also involves the systematic use of empirical evidence (Henderson et al., 1992).

In addition to the agency and stakeholder theories, stewardship theory has been considered a fitting theoretical foundation for research pertaining to the influence of corporate governance with respect to corporate performance and risk (Lemmon and Lins, 2003). Consequently, it has important implications for this study, especially in respect of effective information-sharing mechanisms, which are capable of addressing the information asymmetry problems highlighted in agency theory.

Ontologically, neo-empirical research (positive accounting theory) is known to adopt a solid objective stance. This position further endorses the pre-existence of an objective reality, which is considered to exist independently of the involvement of any human beings, who

are supposed to passively interact with reality, rather than creating it. Such a philosophical stance complements the stakeholder and agency theories. According to Zimmerman (2002:II 417-418), proponents of positive accounting theory believe that it “explains what has been observed, tests empirically the hypothesis derived from the theory, and then predicts what is yet to be observed”. Consequently, the objectivist ontological position and positive epistemology enable the engagement of the hypothetic-deductive methodology. This methodological approach starts with the development of a set of hypotheses followed by the deduction of their subsequent consequences. It finally tests the conclusions to decide on their final validity. Given this considerations, it was proposed to adopt an objectivist ontological and positivist epistemological position since the study is essentially neo-empirical in nature, adopting positive accounting theory (descriptive research) represented by the stakeholder/agency theory. A hypothetic-deductive methodological approach supporting this philosophical stance is thereby adopted as it allows for the testing of research hypotheses.

Chapter 4: Research Design, Methodology, and Hypotheses Development

4.1 Introduction

This chapter presents the overall methodological approach followed to perform the study. Specifically, it discusses the design of the research, the methodology adopted, and the development of the hypothesis. There are five main sections, beginning with a discussion of the research philosophy and the approach taken. The methods used – survey and interview – are then discussed together with the rationale for this decision. The way in which the variables (six independent, two dependent, and four control) are operationalized is presented as also are the assessment criteria. The chapter then describes the econometric models that are employed in the study and the development of the hypotheses.

Data analysis, data analysis techniques, regression analysis, and the test statistics are presented and discussed. Overall, the chapter provides a comprehensive view of the methodological approaches adopted in this study of the effect of particular factors on corporate governance and risk in the UK banking sector.

4.2 Research Philosophy

In respect of the first layer of the research philosophy, Ruddock (2001:27) argues that “ontology and epistemology are significant in that they illustrate how research begins by outlining theoretical suppositions that are taken as given by the research. Ontology relates to how we understand the nature of reality ... epistemology refers to a theory of knowledge. It is related to ontology in that the nature of the reality you set out to explore influences the sort of knowledge that you can have of it ... methodological implications follow. Observations, measurement and interpretation depend on the understanding of the ontological and epistemological nature of the work at hand”. Hence, the researcher must adopt a research philosophy that suits the nature of the study in question.

Generally, in social science research, the researcher makes a choice based on the ontological position. Blaikie (2000 quoted in Grix 2002:177) describes ontology as “claims and assumptions that are made about the nature of social reality, claims about what exists, what it looks like, what units make it up and how these units interact with each other. In short, ontological assumptions are concerned with what we believe constitutes social reality”. The ontological aspect relates to the type of socio-political authenticity being investigated (Marsh and Stoker, 2002), and within this it is possible to identify two different positions – subjectivism (constructionism) and objectivism (realism) – which are considered as the options for conducting any social research (Burrell and Morgan, 1979; Hirschheim, 1985; Chua, 1986; Hirschheim and Klein, 1989; Weber, 2003).

Bryman (2008:18) comments that objectivism “is an ontological position that implies that social phenomena confront us as external facts that are beyond our reach of influence”. Under objectivism, the organization is considered to be a social entity with a tangible reality. Therefore, an organization is characterized as an object with an objective reality. Subjectivism or constructionism differs from objectivism in that it reiterates that the “social phenomena and their meanings are continually being accomplished by their social actors. It implies that social phenomena and categories are not only produced through social interaction but that they are in a constant state of revision” Bryman (2001:16–18). According to subjectivists, objective reality does not exist. Therefore, subjectivism as an ontological position requires the researcher to construct the research objective. For instance, objectivists view the organization’s culture as something that the organization ‘has’ and is in existence. On the other hand, subjectivists consider organizational culture as something that the organization ‘is’. For them, it is a process of continuing social enactment (Smircich, 1983).

Blaikie (2000:8) defines 'epistemology' as "basically being knowledgeable about social reality - how our assumption of what is known to be in existence can be recognized". Epistemology can also be described as the scientific knowledge pertaining to knowledge itself (OED, 2004). On the basis of these definitions, the epistemological position can be described as the technical term that denotes the theory of knowledge. Epistemology refers to the way in which the world is seen. There are two main epistemological positions – positivism and interpretivism.

4.2.1 Positivism

Positivism promotes conventional methods to gather knowledge regarding the inquiry of research. Positivists believe that science can be objectively conducted, and further, that neutral processes result in unravelling the solitary 'truth'. They consider that reality is stable, and hence monitor and showcase everything from a point of view that is objective. This implies that the phenomenon can be isolated and that one can extricate the truth through observations that are repeated (Allen and Gale, 2000). Positivists pursue the procedures that manipulate the reality by holding everything else constant and changing just a singular independent variable. The philosophy centres around the predictions based on what has been seen in the past and the inter-relationships that are present among them. As noted by Hirscheim (1985:33), "positivism has a long and rich historical tradition. It is so embedded in our society that knowledge claims not grounded in positivist thought are simply dismissed as a scientific and therefore invalid".

Epistemological positivism is concerned with the grounds for knowledge in the research work (Remenyi et al., 1998). Positivism predominates in science, the assumption being that science will be able to measure the independent facts connected with a single reality. This position examines the principle concerned by seeking to clarify and define what people themselves experience in a bid to become knowledgeable. Science accepts that boundaries to what can be observed and measured exist, and that it is impossible to extend knowledge beyond those points. Positivists use deductive reasoning to postulate theories which can be tested, and they believe in empiricism, which in itself holds observation and measurement to be at the centre of scientific endeavour. The experimental method is adopted by positivists in an attempt to differentiate natural laws using direct manipulation, and the observation approach. Several definitions of positivism have been developed from the ideas of practitioners and academicians. For example, the following elements are seen to be integral: (i) the rejection of the rule of phenomenalism which postulates that all abstractions are to be rejected; (ii) the notion that the concept of nominalism does not produce a means of gaining or contributing newly-found insight with respect to the world at

large; (iii) the separation of factual data and numeric valuations from each other; and (iv) the unification of scientific methodology.

Researchers who adopt positivism as their paradigm thus derive two crucial benefits, the first being that it allows for research to be conducted in considerably less time than do other paradigms, and the second that it is easier to defend their position owing to the broader acceptance of this particular paradigm in social science research. However, the position is criticized for its inability to consider the way humans behave, and to accept that humans' social lives cannot be explained via quantitative measures. Moreover, the natural sciences endeavour to quantify phenomena through methods that are repetitive, but this approach is not applicable in social sciences. Table 4.1 highlights the features of the positivist paradigm.

Table 4.1: Features of the Positivist Paradigm

Features	Positivist
Paradigm assumption	Objectivity; an approach that is scientific in measuring matters; acquisition of knowledge that is reality-based
Aim of the approach	Discovering laws that are natural and prognosticating human activity
Attitude of researcher	Researchers stay at a distance from issues and the subject to ascertain decision objectivity
Values of the paradigm	Value-free and objective
Approach to reasoning	Deductive
Characteristics of the research plan	Follows rigid research plans developed from various hypotheses
Research and analysis methods followed	Experiments, questionnaires, surveys, quantitative and statistical analysis
Validity and other quality of criteria	Conventional benchmarks of rigid validity, objectivity and reliability

Source: Adapted from Lincoln and Guba (2000) and Gephart (1999)

4.2.2 Interpretivism

In contrast to positivism, interpretivism pursues an approach which tries to comprehend the behaviour and actions of human beings to study social issues. Hence, interpretivists try to understand the situation (Bryman, 2001:13), and in so doing appreciate that subjectivity and bias are bound to be present when studying social issues. Interpretivism assumes that individuals within a society are influencers who have the ability to determine societal structures. Consequently, interpretivists believe a study which ignores man's interpretations, fails to produce any actual meaning. Individual interpretations and meanings as ascribed to societal structures form the heart of the research process for the interpretivist.

Most qualitative research is based on an interpretive approach since qualitative investigations depend upon the participation of human beings for their guidance, control, and direction. According to interpretivist researchers, the experiences of people are necessarily context-bound and conditioned by the time, location or the minds of the human actors. Under the interpretive paradigm, researchers must accept the socially- constructed nature of the social world, and also realize that the values and interests of people, including

themselves, form part of the research process. Language is also considered context-bound, depending on those same values and social location of the researchers as well as the informants. This implies reflexivity on the part of both the researcher and the informants, who must take into account their own position in the setting, as they represent the main research tools. In interpretivism, the interpretation of the world is performed through the mind which creates an ideal, but which also accepts that human beings cannot be made to act in a prescribed manner (to meet the ideal), because they are active and respond to stimuli in different ways. Interpretivists describe people as having intent and the power to interpret. Table 4.2 highlights the features of the interpretivist paradigm.

Table 4.2: Features of the Interpretivist Paradigm

Features	Interpretivist Paradigm
Paradigm assumption	Subjectivity; generation of chances to explore actions; presenting multi-pronged perspective
Aim of the approach	To extricate the truth according to past knowledge and experience
Attitude of researcher	Researcher is part of the research; decisions are made based on subjective interpretation
Values of the paradigm	Vies to construct knowledge; the social location and value are deemed important
Approach to reasoning	Inductive or deductive
Characteristics of the research plan	Approach flexibility based on hypotheses, querying and mulling over makes the gist of the research
Research and analysis methods followed	Structured and semi-structured interviews, groups of focus, qualitative analysis
Validity and other quality of criteria	Reliability and validity

Source: Adapted from Lincoln and Guba (1985), and Gephart (1999, cited in Cavana et al., 2001).

For many years, positivism has been the favoured stance for empirical studies, it being believed that quantitative research is able to provide the perfect foundation for valid generalizations, since non-subjective standards are used. Hence, notions can be operationalized so that the facts can be measured quantitatively, and the independence of the role from the subject under examination enables the researcher to avoid personal biases. Positivism helps problems to be understood, after being simplified. According to

Smith (1998:77), positivism provides clear insights into the research problem, assuming “things can be studied as hard facts and the relationship between these facts can be established as scientific laws. For positivists, such laws have the status of truth and social objects can be studied in much the same way as natural objects”. Positivism has the above unique features and hence, in the context of the UK banking sector, the positivist research paradigm was chosen.

The major advantage of positivism is that it employs empirical methods for the process of verification of research issues, which accordingly do not influence the issue under investigation. The engagement of such methods adds to the validity and reliability of the research outcomes (Smith, 1998), helping researchers to produce universal and accurate findings with regard to the research issues. In principle, these help to explain, predict, and control human behaviour, and are accepted as valid and accurate statements about the world. And because the research outcomes are not influenced by the researcher, it becomes possible to replicate the proof of such truths (Walker and Evers, 1999). However, the positivist approach suffers from the limitation that such blind faith in the paradigm is likely to endanger the reliability of the research. In this respect, the approach may ignore contextual factors about the phenomenon being studied because it believes in applying methods that are designed to draw causal inferences by examining attributes that are only observable (Walker and Evers, 1999). Indeed, social science research in any organizational scenario requires researchers to understand the contextual elements embedded in human behaviour. Another inherent limitation of positivist research is that the paradigm states truth in a probabilistic manner (Walker and Evers, 1999).

However, for this study, the positivist ontological position is adopted because of the systematic and sequential approach it prescribes. The initial step is the development of a formal general statement attempting to check whether theory has been developed, and this leads to the generation of hypotheses to be tested along with an explanation of relevant rules that would need evaluation. Next, a vigilant review of knowledge pertaining to the constructs is undertaken, and hypotheses are subsequently created which seek to measure those constructs, the results ultimately verifying or rejecting the existing theory. Whether the ability of corporate governance variables can affect corporate performance and risk management negatively or positively can be assessed by interacting with the bankers and managers comprising the research sample. This approach was considered better than focusing on fundamental laws. Hence, a positivist ontological approach is deemed suitable for the study.

4.3 Research Approach

The second layer in the research design is concerned with the approach to reasoning, and here the choice is either to follow a deductive (testing theory) or inductive (building theory) path (Saunders et al., 2009). In the natural sciences, the deductive approach is the method that gains precedence over the rest. In deductive reasoning, “laws provide the basis of explanation, permit the anticipation of phenomena, predict their occurrence and therefore allow them to be controlled” (Hussey and Hussey, 1997:52). Robson (2002) suggests a five-step process when adopting deductive reasoning as follows:

1. Deduction of a hypothesis (a testable proposition about the relationship between two or more events or concepts) from the theory;
2. Expression of the hypothesis in operational terms (that is, ones indicating exactly how the variables are to be measured), which proposes a relationship between two specific variables;
3. Testing this operational hypothesis (this will involve an experiment or some other form of empirical inquiry);
4. Examination of the specific outcome of the inquiry (this will either tend to confirm the theory, or indicate the need for its modification); and
5. Modifying the theory in the light of the findings, if and when necessary

Thus it can be seen that the starting point for deductive research is the deduction of an explanation pertaining to the causal relationship between the variables in question, and this search will invariably lead to the development of one or more hypotheses. The hypotheses developed need to be tested using quantitative, or even qualitative data. The testing must be performed via a properly structured methodology that facilitates the duplication of findings (Gill and Johnson, 2002).

In inductive reasoning, the researcher begins by collecting data and then proceeds to analyse them, and on the basis of the result of this analysis, a theory is formulated. It is possible that the researcher may in fact derive the same theory as an existing one, despite using an inductive approach. Under the inductive approach, the theory follows the data as opposed to what happens in the deductive approach, where the data is collected to

prove/disprove a theory that is established at the start of the research (Saunders et al., 2009).

4.4 Choice of Research Philosophy and Approach

This study has adopted the agency-stakeholder theory, which is considered to be an important element of positive accounting theory requiring descriptive research. Positive accounting theory as a part of social research has been used in preference to normative accounting theory involving a prescriptive research approach since the 1970s (Gaffikin, 2007). It is regarded as neo-empirical research because of its reliance on empiricism to establish theory from best practice. It also involves the systematic use of empirical evidence (Henderson et al., 1992).

Positive accounting theory assumes an objective position while tackling the problem at hand. It endorses the pre-existence of an objective reality, which is considered to be independent of the involvement of any human beings. This stance presupposes the passive interaction of human beings with reality, implying that human beings do not create reality but have to live around it. Therefore, it is assumed that it is possible to observe human behaviour objectively and that such behaviour can be predicted as a response to the real world. Consequently, it follows that the social order can be controlled and managed effectively (Gaffikin, 2005). Positive accounting theory is based on the epistemological foundation of empiricism (positivism). Positivist epistemology is based on an assumption of dualism between the subject and object. It is believed that the positivist epistemological position enables the separation between the subject and the object (Keat and Urry, 1975). This position also indicates that the role of the researcher is neutral, implying that the researcher may be unable to influence the issue being observed. Gill and Johnson (1991) note this position to be 'theory-neutral observational language'. It should be noted that both ontological and epistemological positions can have a direct impact on the methodological approach employed to conduct a study.

Accordingly, when research seeks to understand the consequence of epistemological prescriptions, it must follow a nomothetic methodology that seeks to establish law-like generalizations (Gill and Johnson, 1991). According to Zimmerman (2002:II 417-418), the proponents of positive accounting theory base their assumption on the fact that it is "succinctly stated, a theory explains what has been observed, tests empirically the hypothesis derived from the theory, and then predicts what is yet to be observed". Consequently, the objectivist ontological position and positive epistemology enable the engagement of the hypothetic-deductive methodology. This methodological approach starts

with the development of a set of hypotheses followed by the deduction of what succeeds them as a result. It finally tests the ultimate correctness of the conclusions. The hypothetic-deductive methodological approach involves data collection only with the development of a hypothesis in the first place. Positivist epistemology is, therefore, related to the set of phenomena that can be detected in a direct manner and the subsequent hypothetic-deductive verification of the theoretical material. Thus, the development of the theory is the first priority of the positivists before proceeding to verify it. They conclude that the theory is true when the reflection from the real world or the field experiment matches the theoretical assumptions. The theory is assumed to be false when the field observations and the theory do not match (Keat and Urry, 1975; Giddens, 1979).

It is also necessary to determine whether it is appropriate to use the quantitative or qualitative research approach. Quantitative research considers objectivity as not only desirable, but also essential. It believes that qualitative research cannot ensure objectivity and, therefore, must assume the investigation to be subjectively undertaken. Hence, with reference to the objective ontological position assumed by the current study, it was proposed that quantitative research would be the most suitable means of testing the hypotheses developed as deduced from the stakeholder-agency and stewardship theories employed by the study.

Quantitative research is based on the consideration of different variables and is primarily concerned with the relationships between those variables. The variables represent the real world, and given the realist (subjective) ontology, it is possible to objectively determine the causal relationship between the variables, and to generalize the outcome to other, similar situations (set of variables). In this process, the researcher remains distant from data in order to maintain objectivity (Gaffikin, 2005).

The survey technique is the most commonly-used one in quantitative research, and is usually associated with the deductive approach (Saunders et al., 2009). Surveys can present a picture of what many people think or report doing, and as Neumann (1997) observes, these are often employed in descriptive or explanatory studies. This technique facilitates the research of the 'what' question in the form of 'how many' or 'how much' (Yin, 2003; Remenyi et al., 1998). Additionally, surveys allow economically feasible information to be collected from a sample to represent the preferences of the vast and general population – thereby, allowing the researcher to have more control over the research process (Saunders et al., 2003).

In light of the foregoing discussion, it was proposed to adopt an objectivist ontology and positivist epistemological position because this study can be considered as neo-empirical

research adopting a positive accounting theory (descriptive research) represented by the stakeholder/agency theory. To support this process, it is proposed to adopt a hypothetic-deductive methodology, formulating a set of hypotheses to test the theory used. Consequently, survey method is used to collect the required data based on two time horizons, longitudinal and cross-sectional, using two different sources, secondary and primary data respectively.

4.5 Research Paradigm

A paradigm can be considered as a tool to examine social phenomena, and as noted by Saunders et al. (2009), to gain understanding and explanations. The particular paradigm adopted is a feature of the ontological and epistemological decisions made earlier. Figure 4.1 illustrates the four research paradigms developed by Burrell and Morgan (1979).

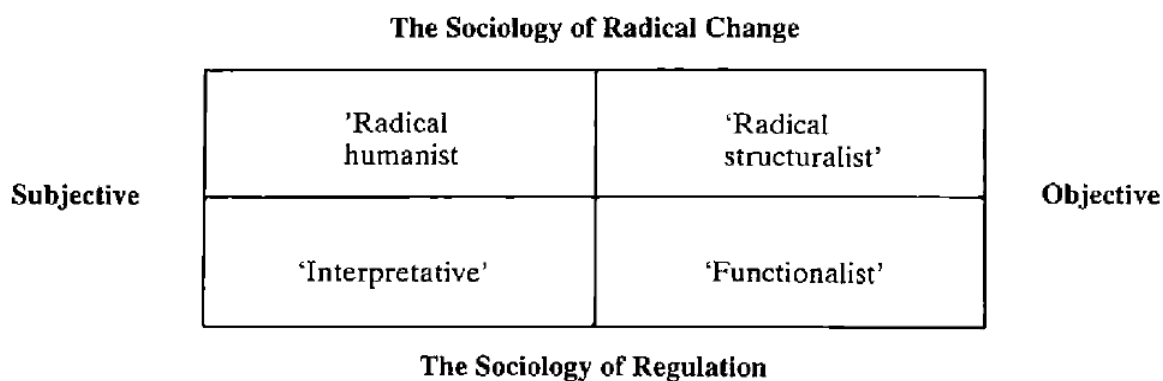


Figure 4.1: Four Social Research Paradigms

The four paradigms correspond to four dimensions: regulation; radical change; objectivist, and subjectivist. The subjectivism and objectivism dimensions which illuminate the ontological position assumed by the researcher, have already been discussed in relation to the research philosophy. The dimension of radical change depicts the precarious effect on the organizational environment, and the regulatory perspective varies according to the degree of this precarious effect, it being seen that regulations are enforced to control variables. The dimension of radical change is concerned with the determination of difficulties faced by companies owing to their current operations, and includes the acquisition of a snapshot of company performance (Burrell and Morgan, 1979). Burrell and Morgan (1979) rationalize the identification of these four paradigms on the grounds that they are able to:

1. Aid researchers in clarifying whatever has been assumed with regard to the nature of society and science;
2. Present an apt comprehension of the manner in which a researcher approaches his work;
3. Aid researchers in plotting their research routes to understand when it is possible to proceed and how. As depicted by Figure 4.1, the radical humanist paradigm lies within the subjectivist and radical change dimensions, allowing researchers “to articulate ways in which humans can transcend the spiritual bonds and fetters which tie them into existing social patterns and thus realize their full potential” (Burrell and Morgan, 1979:32). The ontological position appropriate to this state is ‘subjectivist’. In the radical structuralist paradigm, the researcher’s concern is to make a major change after analysing specific organizational phenomena (Saunders et al., 2009). Burrell and Morgan (1979:31) state that under the interpretive paradigm, “everyday life is accorded the status of miraculous achievement”. This state predominantly requires the researcher to form an understanding of what is actually happening.

Burrell and Morgan (1979:26) note the functionalist paradigm as “often problem-oriented in approach, concerned to provide practical solutions to practical problems”. Objectivism is the ontological position that fits with this paradigm. Based on the discussion of the research philosophy, objectivism is adopted as the current research ontological position. Therefore, the functionalist paradigm would be the appropriate one for the current study as it coincides with its nature and philosophy. Consequently, the thesis will include two research models, differentiated according to the data collection method employed to achieve the research objectives. The first method requires the collection of secondary data using a checklist of different items that forms a secondary data index, while the second is a questionnaire employed to gather primary data from survey respondents. In terms of their time horizons, the first model is a longitudinal survey, whilst the second represents a cross-sectional survey of the different selected groups of respondents.

4.6 Research Methods

Several authors (e.g. Creswell, 2003; Tashakkori and Teddlie, 1998) stress the importance of mixed-methods research, which combines the qualitative and quantitative approaches of data collection and analysis concurrently and sequentially to form a solid understanding of the research query. This approach helps to capitalize on the strengths of the two approaches, and compensate for the weaknesses of each (Punch, 2005). Greene et al.

(2005) observe that mixed-methods research offers more comprehensive understanding from multiple perspectives, more insightful understanding from fresh and creative perspectives, and a greater validity and diversity of values. Practitioners and theorists have formulated qualitative and quantitative methods under paradigms that are interpretivist and positivist. Generally, research based on numeric data is related to positivism while the interpretivist paradigm is more in accordance with non-quantitative techniques (Polit et al., 2001). Proctor (1998) suggested that researchers should explore and appreciate the essential features of both positivism and interpretivism before deciding on any specific research method, and provided the following table to assist in such decision-making.

Table 4.3: Summary of Research Techniques

Scientific/Positivist	Interpretivist/Anti-positivist
Lab Experiments	Subjective/Argumentative
Field Experiments	Reviews
Surveys	Action Research/interviews/observations
Case Studies	Case Studies
Theorem Proof	Descriptive/Interpretive
Forecasting	Future Research
Simulation	Role/Game playing

To examine the influence of corporate governance with respect to the dimension of corporate performance and risk in the context of UK banks, a questionnaire survey reflecting a positivist approach is chosen. The survey method is now detailed.

4.6.1 Survey Method

Most researchers using the positivist paradigm use quantitative surveys for data collection and analysis (Scott and Usher, 2010). Surveys involve designing a questionnaire for completion by the subjects of research. Normally, this instrument is self-administered and allows researchers to gather primary data. This feature offers convenience to respondents, and electronic surveys present even greater convenience for all parties involved.

Cohen and Manion (1980) discuss the aims of quantitative surveys, noting their intention to portray the prevailing conditions concerning any particular issue, and help to identify standards to compare those conditions. Such surveys also aim to determine causality

structures relating to particular events. In the social science research realm, the survey method is pivotal, enabling researchers to gain a thorough view of a given issue. Denscombe (2002) cites the advantages as: (i) providing a thoroughly comprehensive focus, (ii) being relevant in terms of time of the gathered data, and (iii) having the prowess needed to support experimental enquiries. Additionally, surveys have the ability to showcase research outcomes both numerically and quantitatively, depending on the information gathered.

McClelland (1994) suggests that a questionnaire survey is able to collect information that is both relevant and accurate; hence, it is reliable if properly constructed, yet not very costly (Gill and Johnson, 2002). Consequently, questionnaires are trustworthy tools that save much time and effort when conducting research. They enable large amounts of objective data to be gathered, easily recorded and analysed, providing accurate quantitative results, and because of these features they have the important advantage of the potential to generalize their outcomes to very large populations because the actual research samples can themselves be huge. However, the method does have some shortcomings, the first being its inherent impersonal nature, which means that respondents do not have the opportunity to ask for clarification and may misinterpret questions. Consequently, they may provide irrelevant answers which cannot be included in the analysis of data. Another limitation is that the researcher can never be sure that the intended recipient actually completes the instrument, for example, a manager might ask a secretary to complete it on his/her behalf. Nonetheless, the questionnaire survey remains as a popular research method.

4.6.2 Research Methods Selected for the Study

The aim of this study is to investigate the significance of corporate governance system in controlling risk using UK banking sector as case study. For this purpose, the research methodology focused on collecting primary data with the help of questionnaires, which were distributed among bankers and brokers in the United Kingdom. The study adopted a large sample population and had used email survey to deliver the questionnaire to the participants of the study.

4.7 Method of Data Analysis

Empirical quantitative studies adopt a systematic approach to the analysis of data, and use mathematical methods to obtain their findings. Having gathered the data, researchers convert this into a format that can be used to answer the research questions. Data

processing is instigated via editing and codifying the data collected. This entails pruning the data by monitoring legibility, omissions, and classification consistency. The research design characteristics and the nature of the data dictate the mode of analysis. In this study, data analysis was performed using statistical techniques and econometrics (as suggested by Barclay et al., 1993).

4.8 Research Design

The research design incorporated the collection of both primary and secondary data, the former coming from the self-administered questionnaire, and the latter from a variety of data sources including banks' annual-reports covering a the 5-year period from 2006-2010. For the empirical investigation, the researcher had selected annual reports of banks from 2006 to 2010, which were publicly listed in United Kingdom. The reason for selecting banks from 2006 to 2010 was because of several reasons. At the start of 2006, corporate governance mechanisms in UK banks were not effective and instrumental in monitoring bank activities and identifying banks risks and fraudulent activities (Bennette & Kottasz, 2012). In 2007 to 2008, the UK banking sector experienced a decline because of Global Financial Crisis (GFC), which ultimately had a negative impact on banking activities (Jizi et.al, 2014, Bopkin, 2013, Haan & Vlahu, 2016). During this time, critics, academics and industry professionals called for strong and robust corporate governance systems to monitor banking activities, identify risks and control fraudulent activities. The collapse of banks such as Royal Bank of Scotland, Lloyds Bank and Bank of Scotland and their bonus culture during this time further instigated the need and requirement of corporate governance system (Jizi et.al, 2014). According to Haan & Vlahu (2016), the UK banking sector began to adopt strong and robust corporate governance system after the GFC 2008 event. Consequently, from 2009 onwards, the majority of the UK banks had adopted corporate governance system. The sample for empirical investigation, therefore, consisted of banks that have adopted strong and robust corporate governance system after the GFC crisis and had been successful in maintaining it effectively.

The questionnaire was constructed to secure primary data (see Bissett, 1994) regarding corporate governance, corporate performance, and corporate risk management, as reported on in previous research (Appendix III contains the questionnaire distributed to the respondents), and it went through several drafts to ensure the suitability of the questions, especially in relation to the legal and regulatory issues surrounding the topic. In constructing the questionnaire, opinions and suggestions were sought from experts (including the researcher's supervisor) to ensure the development of a complete tool that could address the study's key objectives through the use of both closed and open-ended questions that could be answered by the sample population. The individuals involved in the design and

development of the instrument were: program and data analysts, academics and professionals in the banking and finance sector (also provided advice on ethical considerations), and proposed members of the target population. Eventually a simple instrument was developed that could elicit meaningful information about the research topic. The final version of the questionnaire was divided into two parts, Part A containing general demographic questions about the respondents, and Part B containing 28 questions, 13 of which pertained to corporate governance and performance, and the remaining 15 addressing relational dependence regarding corporate governance and risk.

Ownership structure, role duality, audit committee and its meetings, other board committees, and board composition are some of the issues covered in the first 13 questions pertaining to corporate performance. The influence of the different study variables on the capital and liquidity risk of the banks was covered by the 15 questions in Part B. Respondents were asked to indicate their perceptions using a 5-point Likert scale with options that ranged from “strongly disagree” to “strongly agree.” Some of the questions related to the appointment and functioning of the risk management committee as a corporate governance mechanism and its impact on managing corporate risk.

The questionnaire, which was self-explanatory, was administered in order to obtain information from the listed banks on six corporate governance areas: ownership pattern, the rights of shareholders, the board itself and its members along with the management of the company, matters of diversity within the workplace, disclosure and transparency of important firm-specific data, audits and accountability with respect to financial data, and accountability to the stakeholders. The questionnaire was administered via email for the reasons previously given.

In respect of the research population, it is the researcher’s responsibility to clearly identify this in order to obtain the required information, and here several methods have been developed by theorists and practitioners, each of which has its own merits and limitations. Clearly, the sample selection method must be determined on the basis of the nature of the research inquiry and the data to be collected. Random sampling and purposive non-random sampling are two of the methods that are commonly used by social science researchers, and for this study a random purposive sampling technique was adopted to secure a sample of bankers and brokers in the United Kingdom. These samples were selected from databases such as official local directories and a government information database. Different parameters, like educational background and relevant experience of administering corporate governance in their respective organisations, were used to make the selections.

4.8.1 Rationale for the Selection of Bankers and Brokers

Within the banking sector, bankers and brokers are the key agents of banks, playing complementary roles, and therefore possessing the appropriate knowledge and experience (Mamoghli and Dhouibi, 2009). At the same time, the activities of bankers and brokers have been regulated by a number of agencies. Within the capital market, brokers have dominated the subsidiary roles of financial conglomerates and commercial banks, and thus have practical knowledge of corporate governance, making them a valuable source of information for the study. Bankers, on the other hand, are responsible for putting in place and maintaining a good customer relationship so that an effective sale strategy is created in the organization. Additionally, they also work as managers by providing operational support. Overall, they have practical knowledge of corporate governance, which makes them also an important source of information in the study (Gilley et al., 2002). Thus, the bankers represented the main group with practical knowledge and experience of corporate governance. Brokers, acting as intermediaries between the sellers and buyers in the market, and charging commission for their services (Bhattacharya and Thakor, 1993), may have inadequate knowledge of corporate governance except in a case of a well-organized firm, yet they have other specialist experience (Montgomery and Curotto, 2009). This implies that both groups are critical in the everyday operations of the banking sector, and that they are the logical individuals from whom to collect the data required to support the investigation.

In consideration of the agency theory, within the larger corporate world, bankers as stakeholders have been included in this survey as both principals and agents. As outlined by Denise and Cruse (2002), bankers play an important role, as they are the agents who manage clients' money and take care of the interests of investors, while at the same time they confer certain duties upon brokers to perform for the general benefit of their banking corporations. Brokers, on the other hand, are mainly agents who act as intermediaries between the bankers and customers; to all intents and purposes, the customers and bankers are the principals in this case who make use of the brokers' services to ensure the smooth operation of the banking services. For the reasons outlined above, bankers and brokers form a very rich source of information about corporate management in the banking sector based on their daily functions and tasks. In essence, bankers as stakeholders represent the corporate staff or segment of the financial services sector while brokers represent customers and other business partners. Bankers have an inside view of the corporate banking world and can thus have an informed view of many of its aspects, while brokers understand the situation of the customers and other trading partners with regard to the banking sector (Denise and Cruse, 2002).

4.9 Econometric Models of Corporate Performance and Risk

Econometric models are statistical tools, which are generally defined by the role played by the data in calculating the model's coefficients through a variety of possible estimation methods. They are particularly useful for defining the relationships between variables, because in the social sciences the facts do not speak for themselves. More formally, an econometric model is a way of testing whether there is evidence for a specific hypothesis, e.g. whether variable y has a significant influence on variable x . Although various variables have been identified for this research, it should be noted that some of the variables had been impacted by the financial crisis in negative manner. For instance, the asset growth of some companies has been affected by the crisis in negative manner and therefore, lead to mergers and acquisitions. For instance, Lloyds Bank had taken full control of Bank of Scotland. Similarly, when banks failed during the crisis, it either led to their closure or mergers and acquisitions.

In addition to its vital role in allocating capital to the economy, the banking industry also acts to stabilize the economy as a whole. This study focuses on this task, as exemplified by the Bank of England's monitoring role.

While reviewing the literature it became clear that the research studies dealing with corporate governance within the banking system were few in number, and therefore, several hypotheses were formulated to explore relationships between bank performance and corporate risk, with a view to adding to the current body of knowledge. These hypotheses are as follows:

4.9.1 Board Size

The influence of board size on bank performance and risk has been widely analysed in the literature. Pathan and Faff (2013) in their study conducted among 212 large US bank holding companies over a period of 14 years (1997 to 2011) found that the larger the board, the more likely it is to decrease bank performance, as large boards often face more difficulties in expressing their opinions due to limited time during board meetings. Their findings also reveal that larger boards of directors are less likely to be efficient as far as co-ordination, discussion, and communication is concerned. Similar findings were also obtained by Liang et al. (2013), who using a sample of 50 large Chinese banks for the period 2003–2010, examined the impact of board size on bank performance. They confirmed the findings of Pathan and Faff (2013), observing board size to have a negative effect. Moreover, BOD's with a shrunken board size were considered able to perform their duties

more efficiently because of less interference and better internal control (Jensen, 1993). In an empirical analysis of board size, independent directors, and CEO ownership of eleven Tunisian commercial banks between the periods 1997-2006, it was shown that a small board size was associated with more risk-taking. Such findings were echoed by Pathan (2009), who analysed board size, number of independent directors, and less restrictive shareholders' rights index in 212 large US bank holding companies over the period 1997–2004, finding that a bank board which was strongly orientated towards shareholders, and was small and less restrictive, was more willing to meet the preferences from shareholders for 'excessive risk'.

And from a financial angle, Lipton and Lorsh (1992) asserted that, even if the capacity of the board increases with its size, this advantage would be counterbalanced by the presence of additional costs because of a lack of co-ordination of the efforts of the administrators.

However, a counter-argument is presented by Adams and Mehran (2012) who studied 35 BHCs banking firms involved in Mergers and Acquisitions, and revealed large board size to have a positive correlation with bank performance. They suggest that when connecting board size with other board features, larger boards bring the benefit of more directors to help management to deal with complexity, and thus make overall improvements to bank performance. It should, however, be noted that the banks concerned were involved mergers and acquisitions, and hence, their findings may not be generalizable, especially for small and medium banks that do not engage in such activities.

That said, earlier research by Adams and Mehran (2003), and Blanchard and Dionne (2004) did also point out that when board size is big, the company may perform better since it is more inclined towards a pro-risk conduct. However, Simpson and Gleason (1999) refute this idea, arguing that no such relationship pertaining to the level of profits exists in banking institutes that are already experiencing financial problems. Nonetheless, a large board could provide multiple experiments that will positively influence performance, as revealed by Pearce and Zahra (1992) in their study. In addition it is affirmed that the diversified BOD structure enforces the capacity for control and improves the informational sources.

4.9.2 The Effect of Board Size on Corporate Governance

The impact of the board size on corporate governance structure has been investigated by several researchers and has been explained by several theories (Ciancanelli & Reyes-Gonzalez, 2000, Charreaux, 2004, Masdoor, 2011, Mitchell, 2004, Higgs, 2003, Eisenberg et.al, 1998.). Mitchell (2004), whose study focused on the BOD, considered overall board

demographics, included in which was board size, to be an important determinant of the corporate governance process, and subsequently on organizational performance.

Higgs (2003) argued that boards should be appropriately sized, with approximately 50% of members being independent directors, and Eisenberg et al. (1998) found that in relatively small companies, an inverse proportionality pertaining to the size of the board and the company's subsequent success in the marketplace was evident. Singh and Davidson (2003) also explored this issue, finding that the size of the board is in fact inversely proportional to the company's ability to perform well. Proponents of large boards have used resource dependence theory to support their view (Anderson et al., 2004; Klein, 2002), whilst those of small boards (Linchet al., 2006 Fahlenbrach, 2009) argue that small boards are more likely to facilitate consensus. Raheja (2005), on the other hand, observes board size to be situational depending on the nature of the organization.

According to the agency theory, larger boards are effective in monitoring the performance of corporate and reducing risks since they significantly reduce control of the CEO over the board and focuses on maintaining the interests of the shareholders. Agency theory oriented researchers such as Hermalin and Weishbach (1998) and Singh and Harianto (1989) suggest that larger boards are instrumental in controlling risks and improving corporate governance since role duties of CEO and chairperson are separated (Masdoor, 2011). Agency theorists also stipulate that larger boards increase board independence and improve the monitoring process by dividing the board into different committees, which are assigned specialized duties (Masdoor, 2011).

The findings of the previous literature and corporate governance theories are different. Empirical investigations conducted by researchers suggest that the impact of board size on firm performance and risk are mixed (Clarke, 2004, Abdullah & Valentine, 2009). Corporate governance theories such as agency theory and resource dependency theory suggest that large boards improve corporate governance and risk mechanism. On the other hand, stewardship theory suggests that smaller board size have positive impact on the corporate performance (Bhimani, 2008).

Based on the above discussions, the following hypotheses were developed:

H1a. There is a significant negative link between BS and corporate performance.

H1b. There is a significant positive link between BS and corporate risk.

4.9.3 The Impact of Role Duality on Corporate Performance and Risk

The relationship between role duality and its impact on corporate performance and risk have been studied by researchers and have been explained by corporate governance theories. Agency theory does not support role duality, whereas stewardship theory is its main supporter (Bhimani, 2008). According to stewardship theory, CEO and Chairman role duality can effectively help in improving the shareholder wealth and financial performance of the firm (Clarke, 2004). The theory suggests that role duality can be very beneficial in terms of situations and circumstances that are complex or where resources are scarce. Stewardship theory asserts that role duality is beneficial and can have positive impact on the corporate performance and can help it to avert risks (Abdullah & Valentine, 2009). The stewardship theory suggests that role duality can help organizations to reach value decisions, which can positively impact the corporate performance and reduce risks (Sapra, Subramanian & Subramanian, 2014). Consequently, hypothesis 2a supports the stewardship theory.

According to agency theory, the combination of the CEO and Chairman positions may weaken board control, and negatively affect firm performance. Such role duality is likely to lead to speculation and inefficacy, which may ultimately damage the interests of the shareholders (Jensen, 1993), as internal control systems are weakened. Indeed, shareholders' interests benefit from lower agency costs, when these two roles are distinguished from each other and assigned to different individuals, and it is known that the performance of a company with independent leadership from its managers is better than of a company with the dual leadership structure. Agency theory clearly supports the separation of ownership and control. Agency theory oriented researchers strongly contend that the role duality of CEO and chairman can weaken the corporate governance mechanism internally, which in turn can have negative impact on the corporate performance and risk management mechanism (Sapra, Subramanian & Subramanian, 2014)

. According to Nuryanah & Islam (2016), CEO/Chairperson role duality can have negative impact on the firm's performance. According to Tricker & Tricker, (2015), role duality decreases board independence, which is believed to be the most fundamental aspect of corporate governance mechanism to reach sound and effective decisions. Agency theory, therefore, contends that CEO and chairperson positions should be separated to ensure that the top management does not have control over the board. According to Shivdasani and Yermack (1999), corporate governance monitoring can be decreased by role duality. This has been verified by other agency theory oriented researchers such as Zajac and Westphal (1996) & Westphal and Khanna (2003). Consequently, hypothesis 2b supports agency theory.

Most theoretical arguments concerning the negative influence of the practice of CEO duality on corporate performance have highlighted the problem of power concentration in the dual role of CEO and board chair, which enables the incumbents to have complete control over the board. Such control reduces the effectiveness of the board in monitoring and controlling the management of companies (Fama and Jensen, 1983). Additionally, CEO duality is expected to provide a heightened formal authority, whilst simultaneously providing greater informal power for the individual who holds both positions, with the position of CEO giving power in management implementation and board chairpersonship to provide power for the management control. In addition to the formal hierarchical power that is derived from the position of CEO, by virtue of the position of chairperson of the board, dual CEOs normally tend to exert a substantial influence on the board's activities (Bies, 2004a). By virtue of this extensive power, they can control the information flows to the board and intervene in the process of the appointment of new directors.

Several studies have investigated the potential connection between role duality and firm performance, one being that of Elsayed (2007), who used board leadership structure as his main independent variable, and a binary variable (zero-one) as a proxy for CEO duality. Using data from a sample of 92 firms from different industry sectors, his study shows that the effect of CEO duality on a firm's performance varies with the industry context. Hence, Elsayed (2007) suggests that the correlation between CEO role duality and firm performance should not be considered as monotonic but as a dynamic relationship that can vary depending on the firm characteristics or the industry that a firm operates, and thus, that there is no one optimal leadership structure. These findings are consistent with those established by Brickley (1997) and Boyd (1995) who found that CEO role duality in US corporations may benefit some firms while in others such advantages may not be evident. And yet in a study conducted by Carty and Weiss (2012) among publicly-traded banks in the USA that received Federal bailout funds, no relationship whatsoever was identified between CEO duality and corporate performance after interviewing bank regulators' attitudes to CEO duality. These findings are in line with those obtained by Arouri et al. (2011) who examined the effect of ownership and board characteristics on bank performance in the GCC countries. In contrast, however, a study conducted by Grove et al. (2011) who analysed the relationship between bank performance and 11 corporate governance mechanisms among 236 public commercial banks in the US, revealed a negative association between CEO duality and banks' financial performance. Those researchers concluded that an over-powerful CEO was a key factor leading banks into risky strategies which in turn, led to poor firm performance and, that as a result, several major banks separated the role. 888

However, in a study conducted by Kim and Buchanan (2008), on a sample of 290 large corporations, it was revealed that role duality helped to minimise a firm's risk-taking propensity. The analysis focus on selected governance control mechanisms (CEO Equity Ownership, Board Independence, Board Equity Ownership, and Ownership Concentration) that potentially interact with CEO duality leadership, thereby affecting managerial risk-taking behaviour. The outcome was that CEO duality leads to reduced firm risk-taking propensity, serving managerial risk minimization preferences, a finding which is in line with one of the agency theory principles concerning CEOs (especially those who own shares) and their risk-aversion. Yet, Kim and Buchanan (2008) also found that where role duality existed, board independence and managerial ownership were ineffective in controlling managerial behaviour, while the power balance obtained from concentrated shareholder ownership in the firm has significant impact. In contrast, Switzer and Wang (2013) investigated the relationship between bank credit risks and corporate governance structures including: board size, board independence, institutional ownership, as well as the age of CFO and whether directors serve other firms as CEOs. They found that the separation between the CEO and Chairman was negatively related to the bank's credit risk.

Hence, it can be seen that there is inconsistency in the opinions expressed in the literature regarding CEO/board chairperson duality and corporate performance, and thus the following hypotheses are formulated.

H2a. There is a significant positive link between role duality and corporate performance.

H2b. There is a significant negative link between role duality and corporate risk.

4.9.4 The Impact of Board Composition on Corporate Performance and Risk

Non-Executive Directors (NEDs) are neither company employees nor bear any other affiliation to the company, and have no executive powers whatsoever. They are placed on boards to observe whether the executives are upholding their duties properly and in accordance with the interests of the shareholder groups (Fama, 1980). According to Higgs (2003), NEDs have responsibilities in the areas of strategy, risk, performance and people. They possess two main characteristics that allow them to monitor the firm's functions, which are their independence (Cadbury, 1992) and their market-related reputation (Fama and Jensen, 1983). However, it is the Executive Directors who function as the senior managers of a corporation, and who are remunerated for their work in this respect (Fama, 1980).

Board composition is considered to be an important aspect of the corporate governance mechanism, which can impact the corporate performance and risk. Agency theory supports

the use of external and independent directors, whereas the stewardship theory suggests the use of internal directors for the board (Bhimani, 2008). According to the agency theory, the use of external and independent directors can significantly improve the corporate performance. This is the use of external and independent directors allow the board size to protect the interests of the shareholders by ensuring that board is not influenced by the internal management (Clarke, 2004). According to agency theory, independent directors can help in reducing operational costs and can improve the financial performance of the firm. Independent directors also strengthen risk management mechanism (Abdullah & Valentine, 2009). On the other hand, stewardship theory suggests that the use of internal directors allows the management to protect the firm from “corporate raiders”. The theory stipulates that internal directors help in improving the financial performance of the organization since the CEO and Chairperson are the same. The theory also supports that internal directors are more loyal to the organization as compared to external directors and would be motivated to contribute towards organizational growth and development (Shleifer & Vishny, 1997).

The relationship between the number of independent directors (NEDs) and firm performance has been subject to significant debate and controversy. Although independent directors are believed to be better monitors of managers the findings are mixed. For example, Brickley and James (1987) find that the presence of outside independent directors positively affects managerial behaviour. Similarly, studies conducted by Weir et al. (2002) and Mura (2007) found that the proportion of NEDs in the board has a positive correlation with bank performance. In line with above studies the highlights the importance of NEDs’ contribution in minimizing corporate risk and enhancing performance which is the result of monitoring and scrutinizing the board performance in relation to the set goals and objectives. Apart from the above, as Walker (2009) points out, NEDs can also influence corporate risks by evaluating and ascertaining the integrity of financial information provided by the management. Thus the information asymmetries or bank opacity may be minimized (Batten and Szilagyi, 2011).

This theoretical approach has been confirmed with empirical research conducted among the 50 largest Chinese banks during 2003 to 2010 by Liang et al. (2013). Their analysis revealed that the proportion of independent directors has a significantly positive effect on bank performance through alleviating conflicts of interests between insiders and shareholders, and increasing the effectiveness of top management supervision.

Exploring a random sample of 75 Malaysian listed companies, Abidin (2009) found that the importance of NEDs is better realized with respect to future performance and not in the

short-term. And other evidence exists of a direct relationship between the existence of outside NEDs on a board and performance of both the board and the company (Uadiale, 2010). Moreover, the chance of financial fraud drastically decreases when there is a higher number of independent directors. A comparison of fraudulent firms with an equal amount of non-fraudulent ones would signify a bigger number of directors from the outside on the boards of the latter.

Bhagat and Black (1998), and Kelin (1998) respectively, found a very high percentage of NEDs (76%, and 77%) on US boards, whilst in the UK, that percentage has been identified as 44% by Peasnell et al. (1998), and 39% by Vafeas and Theodorou (1998), thus suggesting that in the UK, the majority of representatives on boards are executive directors.

Although Haniffa and Cook (2005) argue for more NEDs on boards due to their wider expertise and contacts, their results suggest a negative association, indicating that NEDs may lack experience and knowledge. Therefore, it appears that only those directors who bring expertise to the board can positively help to monitor the board and increasing the performance of the corporation (Useem, 1993). Fama and Jensen (1983) suggested that particular directors who are known to be associated with corporate boards have developed this experience and related reputational capital.

Indeed, Bhagat and Black (2002) found no evidence that increasing the number of independent directors improved company profitability, even after performing several tests, adding control variables (board size, firm size, industry effects, CEO and outside directors' stock ownership, and number and size of blockholders), employing OLS and simultaneous framework, using Koenker-Basset robust regression, implementing non-linearity assumptions, and including separate variables for independent and inside directors. Similar results were obtained by Adams and Mehran (2012) who found that the proportion of independent outsiders on the board was not significantly related to performance. Rachdi et al., (2013) who empirically examined 11 large Tunisian commercial banks during 1997-2006, found the presence of independent directors on the board to be negatively correlated with bank performance, and to have no significant effect on risk-taking. Likewise, Pathan and Faff (2013) reported similar outcomes.

Moreover, Agrawal and Knoeber (1996) argue that the effect of NEDs is adverse in terms of performance, as does Yermack (1996).

In general, authors conclude that bank board characteristics and structure are crucial in promoting effective bank performance and bank attitude towards risk-taking, and in light of the aforementioned arguments, this resulting hypotheses has been established:

H.3a There is a significant positive link between the number of non-executive directors and corporate performance.

H.3b There is a significant positive link between the number of non-executive directors and corporate risk.

4.9.5 The Impact of Board Meeting Frequency on Corporate Performance and Risk (DROPPED)

Another important board characteristic that has been found to influence bank performance and risk is the frequency of meetings. Indeed, many studies have shown that this variable can have a profound effect on a company's ability to perform well (Vafeas, 1999; Ryan and Wiggins, 2004). Vafeas (2005) in his study, was able to conclude that when the cost of the firm's shares fall, the frequency of board meetings increases, and if the board continues to meet on a more frequent basis, the company's ability to perform well in an operational capacity may also increase. Hence, it can be concluded that the number of board meetings is a key component behind the board's overall success. In another study by Vafeas (1999) which investigated the relationship between board meeting frequency and firm performance, the researcher used data from a sample of 307 firms between 1990 and 1994, established that the annual number of board meetings is inversely connected to the firm value because share price increases in consequence of more board meetings. Vafeas (1999) does also point out, however, that a higher frequency of board meetings incurs greater costs associated with travel expenses, directors' meeting fees, and managerial time. In a nutshell, this study concludes that boards respond to poor performance by raising their frequency of meetings, and this in turn contributes to improved firm performance.

The findings of this study are similar to those of Hudain and Haniffa (2006) who found that firms' stock performance positively relates to the number of board meetings. The researchers involved suggest that above phenomenon might be connected with better flow of knowledge and information between directors about corporate activities. Certainly, Conger et al. (1998) comment on the fact that the overall amount of time given to board meetings makes the overall board more effective, as these meetings represent the forum in which all company issues can be discussed and decisions taken. Clearly, the intensity with which the board works is reflected by the increase in the frequency of the board meetings. The literature suggests that frequent board meetings are more likely to result in diligent efforts to service the shareholders (Lipton and Lorsch, 1992). Just as the board is accountable for the performance of a company, it is also responsible for monitoring the risk affecting the business of the company by establishing an effective risk management

mechanism. The increased frequency of the board meetings will prove effective in controlling the risks of the company.

Liang et al. (2013) fairly recently confirmed the correlation between board meeting frequency and performance, using a sample of the 50 largest Chinese banks. They found that frequency of board meetings has a positive relationship with ROA at the 10% level of significance. In this regard, they argue that frequency of board meetings is a signal of increased supervision of management. Increased board meetings ensure that board members play a proactive role in exchanging ideas to effectively advise and monitor management what eventually translates to improved performance. Similarly, in a study conducted by Ajanthan, et al. (2013), the positive relationship between board meeting frequency and bank performance was also confirmed. The results of this study revealed that board-meeting frequency is positively correlated with ROE and ROA in state banks, while no relationship was found in private banks. Switzer and Wang (2013) found that more frequent board meetings, or less busy directors, are associated with lower credit risk levels based on default probabilities.

Conversely, a study by Grove et al. (2011) examined the correlation between board meeting frequency and the performance of 236 public commercial banks in the US. These researchers developed several hypotheses relating bank performance with eleven corporate governance mechanisms, specifically: block ownership, anti-takeover provisions, capital structure (with special focus on amount of debt), board size, insider representation, CEO Duality, average age of directors, workload of directors, board meeting frequency, affiliated board committees, and compensation mix. They employed a multiple regression model to examine the impact of these factors on financial performance and loan quality. In terms of board meeting frequency, they found weak evidence to associate it with bank performance.

In fact, however, Lipton and Lorsch (1992) made the point that the commonly faced issue pertaining to directors is time poverty with respect to carrying out their set roles.

Although initially expected to be analysed, the board meeting frequency was dropped from the regression analysis due to the substantial amount of data that was missing pertaining to their values. This decision was made so as to ensure that the validity, reliability and integrity of the analyses were maintained.

4.9.6 The Impact of Audit Committee Size and Constitution

The agency theory supports the use of audit committee since it helps in improving monitoring mechanisms and improves the quality of financial reporting (Cohen, Krishnamoorthy & Wright, 2008). Agency theory perceives the job entrusted to the audit committee to be the monitoring and supervision of financial reporting. Great importance has been placed on the fact that the audit committee's role prevents the production of fraudulent accounting statements. According to Cadbury (1992), the Audit Committee (AC) is an additional control mechanism for ensuring that shareholders' interests are being safeguarded. It should be noted that the AC should improve the credibility of the financial statements so as to benefit the shareholders and other users. Cadbury (1992) suggested that the AC should at least have three members and be comprised only of NEDs.

The agency theory clearly supports the use of external and independent directors for the board size. Furthermore, it supports the use of large boards and believes that they are instrumental in improving the overall financial performance of the organization and risk management mechanism (Turnbull, 2000). On the other hand, the stewardship theory calls for the use of smaller boards and internal directors to improve the corporate performance and risk management mechanism. This is because stewardship theorists believe that internal directors should be recruited since they are highly motivated as compared to external directors. Consequently, the agency theory supports the separation of ownership and control to protect the interests of shareholders and maximize the corporate performance and reduce risk (Ciancanelli & Reyes-Gonzalez, 2000). This is because the agency theory asserts that managers are most likely to take opportunity and behave unethically in order to fulfil their personal interests instead of protecting the rights and interests of the shareholders (Charreaux, 2004). Consequently, the agency theory calls for the use of independent and external directors in the audit committee to oversee supervisory mechanisms. The stewardship model suggests that managers are loyal to the organization and would focus on contributing towards its growth and development since external directors are not motivated to serve the interests of the company. Consequently, the stewardship theory calls for smaller members in audit committee and the use of internal directors (Sapra, Subramanian & Subramanian, 2014).

The impact of the AC on corporate performance has been confirmed by Vefas (1999) who argues that the structure and quality of this committee should allow for effective monitoring of the internal company environment. Moreover, the existence of an AC has a favourable impact not only on the company but also on the market which is more positive to firms that

have such control. Vefcas and Theodorou (1998), however, were not able to find evidence of such a relationship.

The accountability of AC members is seen when a company is accused of failing to disclose relevant financial information by examining the turnover rate pertaining to the organization's directors coupled with losing position with respect to the board as compared to other firms experiencing accounting restatements. Generally speaking, the perks given to AC members have been met with little enthusiasm by directors, largely due to insignificant variations pay along with their relative lack of commonality presently (Engel et al., 2009). Accordingly, the following hypotheses are formulated:

H4a. There is a significant positive significant link between the size of an AC and corporate performance.

H4b. There is a significant negative link between the size of the AC and corporate risk.

H5a. There is a significant positive link between the number of non-executive directors on the AC and corporate performance.

H5b. There is a significant positive link between the number non-executive directors on the ACs and corporate risk.

4.9.7 The Impact of Remunerations and Nominations Committee

According to Ezzamel and Watson (1997), studying companies based in the UK, the characteristics of the remuneration committee were inconsequential in terms of pay and performance, whereas Chi-Kun (2005) found a strong, positive relationship entailing Return on Equity for the two-year period ranging from 1997 to 1999 in determining the top executive remuneration.

The policy changes that have occurred in the UK subsequent to the publication of the Cadbury (1992) and Greenbury (1995) reports should result in compensation committees more effectively linking top executive compensation to the company performance (Conyon and Peck, 1998). Indeed, it has been found in a study that companies have indeed adhered to the Cadbury recommendations in terms of the adoption of proper governing systems, although as pointed out by Laing and Weir (1999), smaller companies have not followed these as well as bigger corporations. It is also shown that existence of separate committees can more effectively influence corporate performance (Klein, 1998), and corporate strategies than can overall board composition, and can also reduce agency problems

(Davidson et al., 2005). Rezaee (2009) observed that companies in Sri Lanka have started introducing board committees due to the fact that such committees are predominantly made liable for overseeing board-related functions. Cadbury (1992) outlined the significance of such board committees as remunerations and nominations committees, indicating their ability to provide an increased focus on the more precise facets of governance that boards may consider problematic.

Nomination committees are entrusted with the job of selecting individuals who possess the specific skills and other requirements to become members of the board. Additionally, they screen the appointment of directors to avoid nepotism or favouritism in appointments. Remuneration committees on the other hand, establish and review the remuneration of the company's senior officers, and have the responsibility to help to reduce agency problems, which they may do by establishing incentives and schemes that align the interests of senior managers with those of the shareholders (Klein, 1998).

Agency theory suggests that suggests that the use of remuneration committees can be beneficial in supervising and advising the organization in terms of pay and compensation (Masdoor, 2011). The agency theory calls for the use of independent and non-executive directors in the remuneration committee in order to ensure that the policies regarding the remuneration paid to directors and managers are transparent and formal (Charreaux, 2004). Therefore, the agency theory supports the creation of remuneration committee for improving firm's performance and controlling risks.

Laing and Weir (1999) discovered that the AC and remuneration committees positively affected the performance of the firm, yet Klein (1998) reported an adverse association, suggesting that because of the lack of specialists on these committees, it may be difficult for them to monitor the top management. Hence, the following hypotheses are developed:

H6a. There is a significant negative link between the existence of a remuneration committee and corporate performance.

H6b. There is significant positive link between the existence of a remuneration committee and corporate risk.

The nomination committee was also dropped from the study, again due to an inherent lack of data.

4.9.8 The Impact of the Risk Management Committee (dropped)

Managing risk is imperative for banking institutes, and thus should form an essential dimension of banks' overall corporate strategy. The process of risk management involves the identification, analysis, measurement, and the overall definition of the amount of desirable risk, and its effective control or transference. BCBS (2011) breaks down the process into four steps, starting from identifying the risk in broad terms, i.e., as 'market, credit, and/or operational', and then categorizing the remaining kinds into more distinct smaller chunks. The next step is to assess the risk with the aid of an existing framework, and the third stage involves the supervision of the risk on a regular basis. The final step is the control of the risks identified.

BCBS (2006) requires that the supervising body should agree on the effectiveness of the risk management framework in place. Hence, the ownership and managing party should be able to ascertain the bank's ability to meet capital needs in the short-term and long-term with respect to the risk management model in place. Al-Tamimi (2002) points out that banking institutes can have a sound framework of managing risk if they follow eight different steps which are: identifying how exposed the bank is to a particular risk, assembling relevant information and quantifying it, comparing this to the aims of the managing body, bringing forward relevant recommendations to control the risk, evaluating the process, devising a strategy to manage the risk, devising an implementation plan for that strategy, and finally evaluating the overall implementation. Mamoghli and Dhouibi (2009) explored the influence of the board of directors' diversity, size, and leadership structure on the insolvency risk of commercial banks in Tunisia, finding that demographic diversity enhances the insolvency risk but that cognitive diversity contributes towards reducing insolvency risk. Additionally, the results show size to have a positive effect on insolvency risk and that duality is associated with a higher risk. Mamoghli and Dhouibi (2009) posited that when the manager is also the chairperson of the board, the insolvency risk could increase. Moreover, they mentioned that in the case of duality, the manager acquires a higher capacity on the board and consequently on the credit of the firm. They suggested that duality has a positive impact on the bank insolvency risk.

Due to the fact that data was missing relating to these variables, they were dropped from the regression analyses in order to ensure that they did not have an adverse effect on the outcomes of the study.

4.9.9 The Impact of Ownership Structure on Corporate Performance and Risk

Investigating Jordanian firms, Zeitun and Tian (2007) found that the structure of ownership significantly influences the accounting practice used to quantify performance with respect to Return on Assets. Laeven and Levine (2009) observe a negative correlation between the amount of risk taken and the extent of managerial control. This finding is confirmed by John et al. (2008) who state that when managers possess increased amounts of control, they choose to be more unadventurous with their investing strategies. Unfortunately, however, the literature is lacking in commentary on the inclusion of ownership structure as a relevant variable in the discussion of banks' strategy for risk taking (Kroszner and Rajan, 1994; Hellmann et al., 2000; Demirguc-Kunt and Detragiache, 2002).

In order to maintain validity and reliability of the attained results of the analyses, these variables were dropped from the study as they did not meet the requirements needed in terms of available data.

4.9.9.1 Free Float

Addressing the agency problems, Fama and Jensen (1983) reported that it is quite costly for shareholders when faced with the matter of separating ownership from control with respect to the present-day firm. Investigating Chinese enterprises, Demstev and Lehn (1985) reported that the optimum point of ownership-structure is closely tied to the type of company, while a competitive industry would further drive the firm near that point.

Saunders et al. (1990) in their study, found owner-controlled banking institutes exhibiting increased risk-preference in comparison to their manager-controlled counterparts. However, that study was limited to the US legal and environmental framework. Kaserer and Moldenhauer (2005) studied the impact of internally-based ownership with respect to the performance of the company, revealing a direct link, and McGuinness and Ferguson (2005) reported that there was an inverse proportionality between Free-Float and the performance of the company. We can see the impact of structure of ownership and performance firm and conclude that there exists a non-linear relation between managerial shareholdings and bank performance. Nations that have concentrated ownership structures coupled with increasingly dictating shareholders often govern management decision-making and exploit minority shareholders, ultimately gaining a firm foothold on how the company is run. Diffuse ownership adversely affects firm performance.

4.9.9.2 *Block-holders*

A study investigated the ramifications of ownership of equity by insiders and ownership of equity by block-holders and other institutions in relation to performance in four developed countries. The study found no relationship between insider ownership and/or block-holders on performance, but found crucial links between performance and ownership inside the case firms. Also, the study further exemplifies the importance of area-specific laws or environmental factors pertaining to the organization. Moreover, the main findings of the investigations of 163 French firms depict an inverse but not that strong a link between block-holder ownership and performance in the market in a one-year time period (Chahine, 2007).

Al-Najjar (2008) reported that business risk, asset liquidity, asset structure, profitability and the size of the company should all be considered before making an investment decision, and that no serious relationship exists between the involvement of institutional investors and dividend policy. And in another study, Linda (2002) found that shareholding pertaining to the non-management block is directly proportional to the valuation of the company.

Karl (2002) in his investigation of the same variables but using a bigger sample of 1,433 firms found a positive correlation with firm value.

4.10 Control Variables

The general study of the factors determining how banks perform, the risks taken by them, and their models of corporate governance, is based on the assumption that all banks face the same conditions and there are no differences between them. Yet, in reality, the ability of a manager to convert inputs to outputs varies over time and space, due to internal bank-specific characteristics (e.g. level of risks, ownership structure) and/or external environment factors (e.g. level of competition). These internal and external factors may be exogenous and influence either the bank performance and/or the risk taken.

Control variables include bank-specific variables, which may have a direct influence on the banks' performance and the level of risk taken. The introduction of bank-specific variables allows one to account for heterogeneity between banks, in terms of the risks and the quality of the banks' output. Heterogeneity implies that there are differences between banks and that each bank has its own characteristics. These characteristics affect bank performance and the risk taken by each bank.

The control variables, which have been discussed and used in the study include the asset growth, intangible assets, bank and year are included in the model to measure the

robustness of the explanatory power of the main variables. The analysis of literature suggests that various researchers and academics have used control variables in their studies to determine the impact of corporate governance and its impact on firm's value and performance. Mitton (2000) conducted the study to investigate the impact of corporate governance on the East Asian companies during the financial crisis. The control variables used in the study by Mitton (2000) for his empirical investigation included firm's debt ratio, leverage and total assets. Eisenberg et.al (1997) conducted the study to investigate the impact of large board size on the firm value. Their empirical investigation focused on Finnish firms. They identified control variables for their study, which consisted of assets and age of firm (Eisenberg et.al, 1997). Bianco & Casovola (1999) conducted a study to investigate the impact of financial structure on firm's performance. The control variables identified by the researchers included total assets and year. Anderson et.al (2004) focused on identifying the relationship between board characteristics, accounting report integrity and cost of debt. The control variables used by Anderson et.al (2004) included firm size, leverage, risk, firm performance and block-holdings. Cornett et.al (2007) study used control variables such as firm size, CEO's sensitivity towards pay performance, age and duration of employment of the CEO, the size of the board, CEO and chairman duality and the percentage of directors, who are external directors and are not related to the board. (Cornett et.al, 2007). Ahmadjian (2016) had identified control variables in his study. His control variables, which he used in the study included leverage, intangible assets and bank tenure. Tam et.al (2016) had used control variables such as leverage and total assets. Researchers such as Gali et.al (2016), Chu et.al (2016) and Dermine (2013) have used control variables in their researches such as intangible assets, bank and year. Other researchers who have used control variables such as intangible assets include Essen et.al (2013), Taani (2014), El-Chaarani (2014) and (Bouvain et.al, 2013). Researchers who have included control variables such as bank and year along with asset growth include Abdumavlono (2012) and Bennette & Kottasz(2012).

4.11 Research Questions

The research questions relate to the influence of corporate governance on performance within the banking sector, specifically addressing two main issues: financial performance and corporate risk, respectively. Hence, the study attempts to respond to the questions of:

1. How corporate governance impacts upon performance, and
2. What part is played by corporate governance in reducing corporate risk?

4.12 Model Specification

Economic model construction requires that all of the relationships constituting the model be specified (Gudeman, 2012). However, similar to the variety of corporate governance characteristics, the academic literature is also full of different approaches to the measurement of bank performance and risk indicators. Specifically, relating to corporate governance in the banking sector, bank performance is assessed with a great variety of measures. Pathan and Faff (2013) used return on average assets (ROAAs), stock returns (SRs), net interest margin (NIM), return on average equity (ROAE), pre-tax operating income (PTOI) and Tobin's Q ratio (Q) as independent variables, while Adams and Mehran (2012) draw their conclusions solely on Tobin's q ratio of physical assets' market value. Rachdi and Ben–Ameur (2011), Ajanthan et al. (2013), and Liang et al. (2013) measured board performance based on Return on Equity (ROE) and Return on Assets (ROA) although in the last case, the pre-provision profitability ratio has also been employed. Grove et al. (2011) measured banks' financial performance using ROA, excess return (Alpha), and the non-performing assets ratio (NPA).

Risk measures reported in the literature on corporate governance are also widely different. Rachdi and Ben–Ameur (2011), in their empirical analysis of eleven commercial banks in Tunisia, measured risk with the Z-score of each bank, which generally equals the ROA plus the capital asset ratio, divided by the standard deviation of asset returns. Roy (1952) and Laeven and Levine (2009) also followed this procedure to measure how far a bank was from insolvency. And Pathan (2009) explored the correlation between board structure and bank risk-taking using three measures: total risk (TR), systematic risk (SYSR), and idiosyncratic risk (IDIOR). Rachdi et al. (2013) measured bank risk using the Z-score, the global risk, and the credit risk of each bank. Switzer and Wang (2013) assessed bank credit with the use of default probabilities. From this discussion, it is seen that the choice of measure is crucial as it directly shapes the final results.

In this thesis, an assumption is made that the specification and model for corporate performance and risks comprise one equation with the same independent variables. The main reason for using the same independent variable is to see how the corporate governance variables (independent variables) affect the performance measures and risk measures. Theoretically, corporate governance affects banks' performance and risk. In the case of banking institutes where the management often acts as sole representatives of the organization and there is the potential for damage to the interests of the other stakeholder parties like customers and ownership, it has been advised that the ownership should constantly improve and update the benefits given to the management (Jensen and

Meckling, 1976). Furthermore, it is the job of the ownership to set up BODs that are capable of facilitating the smooth governing of the company. With this kind of framework in practice, the expectations of the ownership are mimicked by the actions of the management with respect to the amount of risk taken by the overall organization, and these actions have a direct impact on how the banking institute performs and the amount of potential profits earned (Fama and Jensen, 1983).

In addition, there is an apparent link between bank performance and its management of risk, since both factors depend on the implementation of strong corporate governance. The interrelationship between these two constructs depicts the inverse relation between risk and return – the higher the risk, the higher the return; and the lower the risk, the lower the return. However, if risk is managed well, the bank can reap higher returns. Therefore, from a pure business viewpoint, the better the bank is at managing risk, the better it is able to perform as a business institute. Moreover, this ability to manage risk also leads to a better image of the institution in the eyes of the general public or investor-led market (Cebenoyan and Strahan, 2004).

Since the specification and model for corporate performance and risks comprise one equation with the same independent variables, this makes it relatively simple to apply just one equation to measure risk using the same independent variable rather than different ones. The economic analysis shows that the two dependent variables (performance and risks) are correlated and are affected by the same independent variables (board size, role duality, etc).

In a strategic management study conducted by Philip (1991), the risk-taking behaviour of an organization was noted to have a serious impact on economic performance. This study combined performance, risk, projected performance and industry performance, focusing on past performance, the factors affecting risk-taking, and the effect of risk on the future performance of the organization. The results revealed that poor performance was associated with increased risk-taking behaviour, and that risk-taking behaviour affected future performance. This continued even after organizational slack, industry performance, and past performance were controlled. It is evident that risk and performance variables are closely associated. On the other hand, these dependent variables are affected by the same independent variables, so employing the same model for both performance and risk was considered valid for this study.

In this research, the model suggested by Omran (2006) – that of using liquidity and capital risk as a measure of banks' risk, was used for many reasons: (i) the concept of capital is very important for banks because it is considered a first caution to absorb unexpected

losses. Moreover, like all other businesses, banks hold capital as a buffer against losses. Unlike other enterprises, a particular function pertaining to banks is performing financial intermediation between other participants in the economy. The purpose of banking supervision is the assurance of operating with a safety-first attitude. To achieve this, banks must hold enough capital and reserves to offset the associated risk. The BCBS Core Principles for Effective Banking Supervision state that “supervisors must set prudent and appropriate minimum capital adequacy requirements for banks”. Thus, the level of capital held by banks reflects their respective risk appetite. A bank that holds more capital can be viewed as risk-averse, while one that holds less capital can be viewed as a risk-taker. Accordingly, we consider the level of capital of the bank as a good proxy for measuring risk;

(ii) the financial crisis revealed that liquidity could be considered the main risk facing banks. The level of liquidity held by banks represents their respective risk appetite. Banks that hold more liquidity can be viewed as risk-averse, while those with less liquidity can be viewed as risk-takers (Basel Committee on Banking Supervision, 1998). Accordingly, we consider in this research that the level of liquidity held by a bank is a good proxy for measuring its risk;

(iii) we use ROA to measure performance because the use of the z-score as a measure for risk may be unsuitable because there will be a high correlation between ROA and z-score since the former is used to calculate the latter. At the same time, the main banking literature (Pathan, 2009; Akhigbe, and Martin, 2008) has not been used in deriving a model for measuring risk, partly because of its complexity relative to its substantial value in the application of the variables employed in this thesis. Unlike the prior studies, this thesis conducts research on how governance measures enhance performance and reduce risk. The econometric models and specification for performance and risks are now presented:

4.13 Conceptual Regression Model for Performance

The performance model is used to calculate the extent of the relationship of various independent variables with corporate performance because of the interaction between the control variables. The following expression presents the formula used to calculate this relationship. In this expression, β_0 indicates the average performance of corporations without the interaction of the variables. β_1 , β_2 , β_3 , etc., represent the differences between the average performances as they relate to the different independent variables. These variables are indicated by the notations set to represent each of them. The explanations for the notations are provided below. The assets growth, intangible assets, bank and year are the control variables chosen to assess the relationship. On the other hand, e is the residual error term in the sample regression function.

*Performance Measures = $\beta_0 + \beta_1*BS + \beta_2*RD + \beta_3*NED + \beta_4*ACS + \beta_5*ACNED + \beta_6*REMC + CONTROL VARIABLES + e$*

Where:

Performance measures are ROA and ROE

BS Board Size

RD Role Duality

NED Proportion of Non-Executive Directors

AC Audit Committee

ACNED Audit committee of Non-Executive Director%

REMC Remuneration Committee

β_0 Average performance (without the impact of variables)

$\beta_1 - \beta_{12}$ Difference in the average performance

Control variables are Assets growth , intangible Assets , bank and year

e Standard Error

4.14 Conceptual Regression Model for Corporate Risk

The performance model is used to calculate the extent of the relationship between various independent variables and corporate risk because of the interaction between the control variables. The following expression presents the formula used to calculate this relationship. In this expression, β_0 indicates the average risk to the corporations without the interaction of the variables. $\beta_1, \beta_2, \beta_3$, etc., represent the difference in the average risk as they relate to the different independent variables. These variables are indicated by the notations made to represent each of them. Explanations of the notations are provided below. Growth, intangible assets, bank and year are the control variables chosen to assess the relationship. Similarly, e is the residual error term in the sample regression function.

$$\text{Risk measures} = \beta_0 + \beta_1 \cdot \text{BS} + \beta_2 \cdot \text{RD} + \beta_3 \cdot \text{NED} + \beta_4 \cdot \text{ACS} + \beta_5 \cdot \text{ACNED} + \beta_6 \cdot \text{REMC} + \text{CONTROL VARIABLES} + e$$

Where:

Risk Measures are liquidity risk, and capital risk

BS	Board Size
RD	Role Duality
NED	Non-Executive Director
ACS	Audit Committee Size
ACNED	Audit committee of Non-Executive Director
REMC	Remuneration Committee
β_0	Average performance (without the impact of variables)
$\beta_1 - \beta_{11}$	Difference in the average performance
Control variables are Assets growth, intangible Assets and bank year.	
e	Standard Error

4.15 Data and Variables: Definition and Measurement

The data used in this study are obtained from annual financial statements and cover the period 2006-2010, which includes the period both before and after the financial crisis, making it possible to verify the influence of this crisis on the banks performance. The sample is 48 banks operating in the UK.

4.15.1 Performance Measures

The most commonly-used ratios for measuring bank's performance (profit) were used in this study, these being: ROA and ROE (Zeitun and Tian, 2007). ROA is net profit before tax divided by average assets, and measures the ability of the assets used by the bank to

generate profits. The ROE equals the profits before taxes divided by the average equity, and measures the rate of return that the shareholders receive on their investment. In this research, it is assumed there is a relationship between the performance variable as a dependent variable and corporate variables as variables that are independent.

4.15.2 Study Variables

The study variables include two dependent variables: performance and risk. As a measure of performance, consistent with the literature, ROA and ROE are used. As a measure of risk, capital and liquidity risk are used. Performance and risk are determined by the same independent variables as they relate to each other to reduce the amount of data used and facilitate analysis. Corporate governance mechanisms encourage the management of risk and performance among banking institutions, and lead to improved ability to reduce risk by preventing exploitation by the controlling directors. The same variables are corporate variables. A description of these independent variables and predictor variables appears in Table 4.3.

Table 4.4: Summary of the Terms of Measurement

Variables	Terms of measurement
BS (board size)	Number of directors on the board (Uadiale, 2010; Eisenberg et al., 1998; Black et al., 2006)
Duality	If the CEO and Chairperson is the same person 1; if not, 0 (Uadiale, 2010; Black et al., 2006)
Meetings(dropped)	Number of meetings/year (Vafeas, 1999)
Non-executive Directors	% NEDs in Board
Non-executive Directors in AC	% NEDs in AC
Free Float(dropped)	% of ownership
Block Holders(dropped)	% of block holders
ROA	Ratio of net income to book value assets (Clarkson et al., 2006; Abdullah, 2006; Omran, 2006)
ROE	Ratio of net income to shareholders` equity (Uadiale, 2010; Sunday, 2008; Omran, 2006; Zeitun and Tian, 2007)
Liquidity Risk	Investment securities/total assets (Omran, 2006)
Capital Risk	Core capital to assets and loans/total capital (Omran, 2006)
Bank age	Number of years since listing or establishment
Growth	Average assets growth over a particular period (5 years)
Intangible Assets	Total assets
Remuneration Committee	Dummy variable 1 if there's a committee; 0 if not
Nomination Committee (dropped)	Dummy variable 1 if there's a committee; 0 if not
Risk Management Committee (dropped)	Dummy variable 1 if there's committee listing; 0 if not
AC Size	Number of directors in AC
AC Meeting (dropped)	Number of meetings/year

4.16 Endogeneity and Causality Problem

Discussion about the influence of board characteristics on corporate performance must include the problem of endogeneity (especially simultaneity, reverse causality, and unobserved heterogeneity) as this may precipitate biased and inconsistent estimates as a result of the expected correlation between the error term and the endogenous variable. Wintoki et al. (2012) refer to 'dynamic endogeneity' as an occurrence seen when a firm's current performance affects both its future performance and its governance. However, as several studies suggest, dynamic endogeneity in banks is less problematic because a bank's past performance, a proxy for management capability, does not affect either its board size or its composition (Pathan and Faff, 2013).

Board structure might be endogenously formed (e.g., Adams and Ferreira, 2007; Hermalin and Weisbach, 2003). As an example of the above phenomenon, Linck et al. (2008) point out that both board size and number of independent directors decreases with firm uncertainty as measured by return variability. Similarly, Pathan (2009) noticed the causation problem of board structure and bank risk, when a higher level of risk may trigger the board structure changes. Kim and Buchanan (2008), and Grove et al. (2011) noticed that firm risk may influence the adoption of CEO duality leadership rather than the opposite. The causality problem may also appear in the frequency of board meetings, when poor financial performance triggers the need for more discussion between directors.

Different authors have employed different techniques to deal with endogeneity problems. The most common approach is the use of the generalized method of moments (GMM) method developed by Arellano and Bover (1995), since this enables the estimation of a dynamic model that can reduce the endogeneity problem in corporate governance variables, like for example, board size and independence. This method focuses on a system of two equations, the first being the original equation of variables in levels, and the second a counterpart equation based on different variables ('system GMM'). This method has been used in a number of studies on the relationship between corporate governance mechanisms and financial performance. Using a system GMM estimation technique to control for all the important sources of endogeneity, such as dynamic, fixed effects and simultaneity in governance and other firm characteristics, Wintoki et al. (2012) report no relationship between board size or board independence and firm performance. The GMM method has been also employed in studies conducted by for example, Rachdi and Ben-Ameur (2011), Pathan and Faff (2013), and Liang et al. (2013). Usually the GMM technique is supplemented with other tests. Rachdi and Ben-Ameur (2011) complemented it with the Arellano and Bond test in order to detect autocorrelation in terms of the levels of his selected

variables. The validity of the instrumental variables was tested with the use Hansen's test to over-identify restrictions and test for the absence of serial correlation of the residuals. In this research, the final sample comprises a small number of banks, thus, the one-step GMM-in-System estimator (instead of two-step approach) was used.

The endogeneity problem can also be addressed by other methods than the GMM technique. For instance, in a study by Adams and Mehran (2012), a potential reverse causality problem was envisaged in relation to board size and BHC complexity, but the authors did not find any appropriate instrumental variable that correlated with board size but not with performance which was suitable for their research. Furthermore, they were concerned that their results could be driven by endogeneity due to variables related to Mergers and Acquisition activity which were omitted. In order to overcome this problem, the authors analyzed their sample during a time period when little or no M&A activity took place.

Pathan (2009) addressed the causation problem of board structure and bank risk by replacing the contemporaneous board structure variables with their lag values. This approach has been further supported by the development of appropriate regression equations. In order to solve the problem of possible endogeneity, Elsayed (2007) employed the solution presented by Gujarati (2003) who proposed the Hausman specification. In this approach, the null hypothesis of the Hausman test indicates that there is no endogeneity and that the Ordinary Least Square (OLS) estimates are consistent. The application of above method required a reduction of the equations for CEO duality and board size, such that each equation included only the pre-determined variables. The result of the F-test for either the ROA model or Tobin's Q did not provide any evidence of endogeneity, and thus the null hypothesis could not be rejected. In order to address the reverse causality issue, Liang et al. (2013) conducted additional robustness testing. As better financial performance may trigger the adoption of modern governance mechanisms, the authors analyzed the bank behaviours in relation to whether board structures had been adjusted during the recent financial crisis when the banks' financial performance had been poor. The analysis revealed that the bank board structure was not influenced by bank performance and reverse causality. A similar approach was adopted by Grove et al. (2011). Arouri et al. (2011) present the correlation matrix and conducted multicollinearity analysis (employing the Variable Inflation Factors technique) in order to control the potential correlation between dependent and independent variables. They found no evidence of multicollinearity between the model's variables. However, some authors recorded possible endogeneity between risk and CEO duality. For example, Kim and Buchanan (2008) and Grove et al. (2011) noticed that firm risk may influence the adoption of CEO duality leadership rather than the opposite,

and suggest that this issue be a topic for future research in order to learn how to control such causality.

4.17 Conclusion

This chapter has outlined the process of selecting an appropriate research design to examine the role of corporate governance in improving corporate performance and risk management within the UK banking sector. It has also developed the hypotheses that the study sought to test in order to answer the research questions. Thereafter, the chapter has introduced and described the econometric models that were employed during this study.

It has been shown that having adopted the agency-stakeholder theory, which is an important element of the positive accounting theory, requiring descriptive research, the decision to adopt the positivist epistemological position, noted by Keenan and Urry (1975) to enable the required separation between the subject and the object, was taken. This position also indicates that the role of the researcher is neutral, implying that the researcher may be unable to influence the issue under observation. Gill and Johnson (1991) observed this position to be 'theory-neutral observational language'. It was noted that both ontological and epistemological positions can have a direct impact on the methodological approach employed to conduct the study, and that accordingly, the study followed a nomothetic methodology that set out to establish law-like generalizations. This objectivist ontological position and positive epistemology was shown to enable the engagement of the hypothetic-deductive methodology, and in determining the appropriateness of the approach, a quantitative method was chosen because this is considered not only a desirable element of research, but rather an essential aspect. Qualitative techniques were shown not to ensure objectivity, and hence, with reference to the objective ontological position assumed by the current research, it was proposed that quantitative research would be the most suitable approach for testing the hypotheses developed as deduced from the stakeholder-agency and stewardship theories employed by the study. On the basis of the discussions of several aspects of research methodology, it was proposed to adopt an objectivist ontology and positivist epistemological position because this research can be considered neo-empirical research, adopting a positive accounting theory (descriptive research) represented by the stakeholder/agency theory. To support the research, it was proposed to adopt a hypothetic-deductive methodological approach because it fits with testing the employed theory by devising a set of research hypotheses. Consequently, this research employed quantitative research as appropriate for the objectivist ontological position to examine the set of developed hypotheses. Strategically, the research uses the survey method to collect the

required data based on two time horizons, longitudinal and cross-sectional, and through two different sources, secondary and primary data, respectively.

On the basis of the discussion of research philosophy, objectivism is adopted as the current research's ontological position. Therefore, it was decided that the functionalist paradigm would be an appropriate choice given the current research nature and philosophy. Consequently, the thesis was designed to include two research models. The differentiation is based on the data collection method employed to perform the research objectives. The first method is secondary data collection using a checklist of different items that forms a secondary data index. The second method is a questionnaire employed to gather primary data from the different survey respondents. Moreover, the two research models are classified based on the survey time horizons. The first model is considered to be a longitudinal survey for the selected sample. On the other hand, the second model is a cross-sectional survey of the various selected groups of respondents. The study was based on the data collected through a self-administered questionnaire exploring corporate governance (Arijiti, 2003). In addition, the necessary financial data were gathered as secondary data, with specific information being taken from the bank annual reports for the five-year period (2006-2010). The study also used two econometric models – the performance model and the risk model – empirically, to analyse the data collected. It developed six hypotheses, proposing the dimension and directions of various corporate governance variables to test their association and impact on corporate performance and risk. These hypotheses were tested using the econometric models and on the basis of the statistical analysis of the data collected from the survey.

Chapter 5: Empirical Results and Analysis

5.1 Introduction

This chapter presents an analysis of the data, specifically to determine the effect and influence of the independent variables on the dependent variables, in order to identify the influence of corporate governance on bank performance and risk. The analysis is made through the use of regression analysis software PROC GLM in SAS 9.4. The regression encompassed fixed models where Year and Bank remained constant due to the same banks being used in each instance. Growth and Intangible Assets by bank and year were used for controls in the regression models.

5.2 Missing Data

One of the main concerns about the data was the problem of missing values, as there were very many. This was not anticipated as the information was sourced from publications such as banks' annual reports, and the banks' official websites. From these sources, it would be expected that full records of data would be attainable, since these reports are required to provide information regarding a bank's activities and finances for the preceding year and should be complete with no missing data. However, it has been noted by Hatch (2006) that banks may simply choose not to publish certain figures as they are deemed likely to cause issues with the status or valuation of the banks or even, in some circumstances, for the purpose of covering up wrongdoing (Hatch, 2005).

The UK Corporate Governance Code establishes a set of principles, specifically pertaining to Section C – Accountability, which must be followed for any bank listed on the LSE. Section C section states that it is the board's responsibility to present an accurate assessment of the bank's position. Therefore, all data and information in this regard should be readily obtainable and easy to understand.

Studies by Batten and Szilagyi (2011) highlight instances of the banks' lack of transparency and willingness to share key information regarding statistics has been evident in the past. This has been for reasons relating either to the protection of the respective banks' reputation or to the desire to gain a financial advantage. Furthermore, the Walker Review (WR), showed that the influence of the Board might not always be positive. Specifically, the board may show a bias toward revenue and profit generation (Walker 2009).

For these reasons, banks may not be as willing to share financial information as openly as they should be, despite the governance codes. This presents obvious challenges for those wishing to analyse and model the data of the banks as some of it simply is not disclosed.

Where missing values are present, any multivariate analysis of the data must be limited since missing values on one analysis variable result in all values being missing for an observation in an analysis (listwise deleted). Therefore, the strategy to address this issue was to replace missing values in the data with mean average values in continuous variables and mode values in (binary) categorical variables.

There were two stages in this process in respect of continuous variables. In the first stage, means were calculated at bank level before and after the crisis. Thus, if a bank provided any data for the period 2006-2008 or from 2009-2010, the mean average for this period for the bank was used to replace missing values.

Where no data was available for the bank in this period, the mean average for all banks by year was used. For example, if a bank had no data for the year 2006, then the mean average for all banks for 2006 would be used to replace the missing value. It was necessary to calculate the mean values by year rather than crisis for this purpose as year was to be used as a control variable in the regression analyses.

Table 5.1 on page 154 shows the imputed missing values for the variables in the data, from which it can be seen that a large number of values were missing for many of the descriptors. Problematically, it was necessary to impute around 40% values seen for free float, audit committee meetings, and block holder.

The substantial amount of missing data explains why these variables were not included in the analysis and, therefore, not fitted into the regression models. It should, however, be noted that ROA and ROE had no missing values, and hence, no imputation was necessary.

Table 5.1: Imputed Missing Values

Imputed Missing Values: Numbers and Percentages Replaced with Changes of Means and Standard Deviations due to Replacement

Name	Description	Missing Values Before Imputation by Year					Total Missing	Replaced		Total Replaced	% Replaced	Before Imputation		After Imputation		% Mean After Minus Before
		2006	2007	2008	2009	2010		Bank Level	General			Mean	Stan Dev	Mean	Stan Dev	
liquidity_risk	Liquidity Risk	4	8	7	8	6	33	26	7	33	14.04%	11.24	8.95	10.84	8.85	-3.55%
Capitalrisk	Capital Risk	4	8	7	5	5	29	24	5	29	12.34%	11.02	8.18	10.74	8.17	-2.50%
Logfs	Logfs	8	5	4	2	7	26	20	6	26	11.06%	5.36	1.24	5.34	1.24	-0.33%
Loglev	Loglev	8	6	5	3	9	31	20	11	31	13.19%	3.03	0.41	3.03	0.41	0.11%
BS	Board Size	4	6	3	4	7	24	19	5	24	10.21%	12.55	4.37	12.36	4.26	-1.52%
BM	Board Meeting	24	21	13	12	13	83	34	49	83	35.32%	11.82	8.11	11.44	7.04	-3.22%
B_NED	Proportion of Non-Executive Directors	18	12	7	5	13	55	38	17	55	23.40%	7.76	3.28	7.67	3.02	-1.05%
AC	Audit Committee Size	13	9	6	8	8	44	24	20	44	18.72%	3.79	1.33	3.84	1.27	1.41%
AC_NED	Audit Committee % of Non-Executive Directors	18	13	8	8	9	56	27	29	56	23.83%	3.39	1.39	3.36	1.31	-0.84%
ACM	Audit Committee Meeting	26	18	17	18	16	95	31	64	95	40.43%	9.26	7.18	9.03	6.11	-2.44%
FF	Free Float	21	21	14	12	26	94	34	60	94	40.00%	38.77	29.00	38.21	24.93	-1.43%
BH	Block Holder	20	20	14	11	26	91	33	58	91	38.72%	61.09	29.34	61.02	25.57	-0.12%
Firmage	Age of Firm	3	3	3	3	3	15	0	15	15	6.38%	79.45	77.82	79.45	75.28	0.00%
Growth	Growth	3	3	3	3	10	22	7	15	22	9.36%	405,271.76	1,171,051.73	412,120.47	1,142,142.25	1.69%
Intangible_A	Intangible Assets	9	10	10	12	16	57	21	36	57	24.26%	15,483.46	43,547.13	14,400.43	38,419.26	-6.99%

5.3 Data Transformation

In order to improve the quality of the variables before analysis, several of the variables had to be transformed.

The visual inspections of the data indicated that several of the analysis variables were very skewed and appeared to follow a log-normal distribution or similar skewed distribution. Using the Box-Cox method of Power Transformations (Box and Cox, 1964) and other methods such as checking histograms and normality, it was possible to identify the best procedure for transforming the variables.

It was found that Board Meeting, Audit Committee Meeting, Firm Age, Growth, and Intangible Assets were all best transformed using the natural log. Due to the use of the log transformation, this also meant that, where values of zero were present that these had to be replaced so that they would not return as missing values (infinity).

The replacement method used was that, where Growth and ACM were zero, the log of the value was replaced with a zero value (instead of an infinity missing value). For Intangible Assets, the natural log of 0.1 was taken to replace the value. This was due to some values of Intangible Assets being less than one. Where this was the case, these were returned as negative when transformed. For this reason, it was necessary that the value of zero was lower on the scale than the lowest item found within the data.

The methodology for checking the data indicated that other variables were better suited to transformations using the square root of the variable rather than the natural log to achieve improved normality. Liquidity Risk, Capital Risk, and Free Float were all transformed using this method. A further transformation was used on Block Holder by squaring the variable and dividing the result by 1,000 (the division being used to scale the variable to make statistics related to this variable easier to present). The remaining variables were deemed suitable for use without transformation.

In Table 5.2 on the (page 157), the Kolmogorov-Smirnov D statistic (a measure of normality) is shown for before and after transformation. In most cases, the transformation has reduced the D statistic considerably (increased normality). The exception to this is Capital Risk that does not appear to have changed greatly based on the results of the normality tests. However, visual representation using histograms indicated that the variable was better distributed after transformation than before. Therefore, the use of the transformed variable was preferred despite the lack of change in the D statistic.

Where a Kolmogorov-Smirnov test is significant, it indicates that the distributions are non-normal. Most of the items are still significantly non-normal according to the Kolmogorov-Smirnov test. However, it should be noted that this test is very conservative and likely to indicate non-normality (Steinskog et al., 2007).² Therefore, despite the tests indicating that the variables were still significantly non-normal, enough improvement had been indicated on these tests to continue analysis with these variables.

² Steinskog DJ, Tjostheim DB, and Kvamsto NG, A cautionary note on the use of the Kolmogorov-Smirnov test for normality. *American Meteor Soc.* 2007;135:1151–7. See: http://folk.uib.no/ngbnk/Publications/Steinskog_etal_MWR_07.pdf

Table 5.2: Descriptive Statistics for Variables Before and After the Crisis

Descriptive Statistics of Continuous Variables by Group

Question	Group (Crisis)	N	Mean	Std Dev	Median	Sum	Min	Max	Kolmogorov-Smirnov		
									D (Before Transform)	D (After Transform)	p-value (After)
ROA (Return on Assets)	All	235	1.81	2.31	1.36	424.86	-13.28	11.25	NA	0.14	<.0001
	Before	141	1.60	1.82	1.22	225.68	-4.49	7.78	NA	0.16	<.0001
	After	94	2.12	2.88	2.14	199.18	-13.28	11.25	NA	0.14	<.0001
ROE (Return on Equity)	All	235	2.92	3.11	2.72	686.78	-14.80	14.74	NA	0.11	<.0001
	Before	141	2.73	2.52	2.45	385.26	-7.84	9.91	NA	0.14	<.0001
	After	94	3.21	3.82	3.55	301.52	-14.80	14.74	NA	0.11	0.0169
SQRT_LR (Square Root of Liquidity Risk)	All	235	2.90	1.57	3.28	680.99	0.00	6.15	0.11	0.10	<.0001
	Before	141	2.78	1.60	3.08	392.34	0.00	6.15	0.13	0.09	<.0001
	After	94	3.07	1.50	3.38	288.65	0.00	6.13	0.09	0.12	<.0001
SQRT_CAPRISK (Square Root of Capital Risk)	All	235	2.93	1.47	3.26	689.23	0.00	6.17	0.09	0.10	<.0001
	Before	141	2.86	1.50	3.19	403.80	0.00	5.76	0.10	0.10	<.0001
	After	94	3.04	1.42	3.31	285.43	0.00	6.17	0.08	0.12	<.0001
BS (Board Size)	All	235	12.36	4.26	12.00	2904.29	5.00	27.00	NA	0.13	<.0001
	Before	141	12.33	4.28	12.00	1738.49	5.00	27.00	NA	0.12	<.0001
	After	94	12.40	4.25	12.00	1165.80	5.00	25.00	NA	0.15	<.0001

LOG_BM (Log of Board Meeting)	All	235	2.28	0.56	2.40	536.34	0.69	3.89	0.23	0.12	<.0001
	Before	141	2.28	0.54	2.40	321.82	0.69	3.64	0.23	0.14	<.0001
	After	94	2.28	0.59	2.40	214.52	0.69	3.89	0.22	0.10	0.0304
B_NED (Proportion of Non-Executive Directors)	All	235	7.67	3.02	8.00	1803.38	0.00	23.00	NA	0.11	<.0001
	Before	141	7.53	2.86	7.45	1062.31	0.00	21.00	NA	0.12	<.0001
	After	94	7.88	3.26	8.00	741.07	2.00	23.00	NA	0.12	<.0001
AC (Audit Committee)	All	235	3.84	1.27	3.87	903.38	0.00	7.00	NA	0.20	<.0001
	Before	141	3.80	1.26	3.79	536.13	0.00	6.00	NA	0.19	<.0001
	After	94	3.91	1.29	3.91	367.26	2.00	7.00	NA	0.22	<.0001
AC_NED (Audit Committee % of Non-Executive Directors)	All	235	3.36	1.31	3.00	788.93	0.00	8.00	NA	0.18	<.0001
	Before	141	3.25	1.38	3.00	458.84	0.00	8.00	NA	0.19	<.0001
	After	94	3.51	1.19	3.00	330.09	1.00	6.00	NA	0.25	<.0001
LOG_ACM (Log of Audit Committee Meeting)	All	235	2.01	0.65	2.14	472.98	0.00	3.78	0.22	0.15	<.0001
	Before	141	1.98	0.68	2.14	278.98	0.00	3.78	0.23	0.16	<.0001
	After	94	2.06	0.61	2.22	194.00	0.00	3.61	0.23	0.14	<.0001
SQRT_FF (Square Root of Free Float)	All	235	5.79	2.18	6.09	1359.71	0.46	9.78	0.18	0.14	<.0001
	Before	141	5.71	2.19	6.06	805.67	0.46	9.78	0.18	0.14	<.0001
	After	94	5.89	2.18	6.20	554.04	0.62	9.78	0.19	0.15	<.0001
SQ_BH (Block Holder Squared/1000)	All	235	4.37	2.81	3.98	1027.93	0.00	10.00	0.17	0.14	<.0001
	Before	141	4.55	2.78	4.03	641.73	0.02	10.00	0.18	0.15	<.0001
	After	94	4.11	2.86	3.53	386.20	0.00	9.92	0.19	0.17	<.0001
LOG_FIRMAGE (Log of Age of Firm)	All	235	3.89	1.11	4.06	913.20	0.00	5.77	0.20	0.09	<.0001
	Before	141	3.84	1.17	4.04	542.07	0.00	5.76	0.20	0.10	<.0001
	After	94	3.95	1.03	4.09	371.13	1.39	5.77	0.20	0.08	0.1201

LOG_GROWTH (Log of Growth)	All	235	10.32	3.44	11.35	2426.02	0.00	15.97	0.38	0.15	<.0001
	Before	141	9.92	3.79	11.07	1398.98	0.00	15.63	0.36	0.19	<.0001
	After	94	10.93	2.76	11.72	1027.04	3.51	15.97	0.41	0.15	<.0001
LOG_INTANGIBLE_A (Log of Intangible Assets)	All	235	6.95	3.39	7.79	1633.13	-2.30	12.62	0.35	0.12	<.0001
	Before	141	6.69	3.45	7.20	943.15	-2.30	12.34	0.36	0.10	<.0001
	After	94	7.34	3.27	8.15	689.98	-2.30	12.62	0.38	0.15	<.0001

5.4 Variable Correlations

Table 5.3 on page 162 shows the Pearson correlations of the transformed variables. Most correlation coefficients are very weak, suggesting that they are close to being independent of each other. However, there were some strong correlations found, with these variables expressing a tendency to increase/decrease with regards to each other. For example, ROA and ROE were found to be very strongly correlated ($r=0.91$, $p<.0001$) (as would be as expected). It should be noted that ROE and ROA both act as measures of a company's ability to generate earnings from investments. However, correlating these measures can provide a more realistic and truer representation of a company's performance (Abreu, 2001).

Similarly, Liquidity Risk was found to be highly correlated with Capital Risk ($r=0.93$, $p<.0001$). This correlation indicates how the source of funds from different forms of assets and liabilities are linked to one another (Altunbas et al., 2007). These items were to be used as dependent variables in regression analyses independently from one another so the correlation between these measures of risk was not deemed to be an issue.

Data suggests that the size of a corporation's audit committee does not have an effect on the performance of the organisation as a whole in regard to ROA and ROE. However, this cannot be stated conclusively due to the nature of the raw data available

A very significant correlation was found between Free Float and Block Holder. The transformed variables were almost completely negatively correlated ($r=-0.98$, $p<.0001$). This finding indicates that these variables could not be used together in a regression analysis as predictors due to the likelihood of multicollinearity.

There were other interesting correlations found in this analysis. For example, Log Growth and Log Intangible Assets were found to be correlated ($r=0.55$, $p<.0001$). This indicates that where the organisation has more intangible assets, growth also increases in tandem. Conversely, smaller growth would be indicative of a decline in these non-physical assets.

Board Size was found to be correlated with the proportion of non-executive directors ($r=0.54$, $p<.0001$). There was also a reasonably strong correlation between Board Size and Audit Committee Size ($r=0.43$, $p<.0001$).

Audit Committee Size was also found to be moderately correlated with the proportion of non-executive directors ($r=0.39$, $p<.0001$) and the percentage of Audit Committee Non-Executive Directors ($r=0.63$, $p<.0001$). Non-executive directors are also often part of an organisation's audit committee and, as has been mentioned previously, the size of both has

been documented as decreasing post-recession. Hence, this moderate correlation can be explained by this duality of roles.

The age of the firm was also found to be correlated with both Growth ($r=0.37$, $p<.0001$) and Intangible Assets ($r=0.40$, $p<.0001$). Audit Committee Size (using proportion of non-executive directors) was also moderately correlated with Board Size ($r=0.45$, $p<.0001$). Logically, fewer members of a board would mean that fewer audit committee members are required for oversight. It should be noted, however, that, as indicated by the correlation coefficients, the relative sizes of audit committee and numbers of NEDs might not be directly proportional to one another.

Table 5.3: Pearson Correlations of Analysis Variables

Pearson Correlation Coefficients, n = 235

Variable (Transformed)	Statistic	ROA	ROE	SQRT_LR	SQRT_CAPRISK	BS	LOG_BM	B_NED	AC	AC_NED	LOG_ACM	SQRT_FF	SQ_BH	LOG_FIRMAGE	LOG_GROWTH	LOG_INTANGIBLE_A
ROA	R	1.00	0.91	-0.02	-0.02	-0.05	0.12	-0.08	-0.08	-0.12	-0.03	-0.06	0.06	0.05	0.13	0.06
Return on Assets	<i>P</i>		<.0001	0.7372	0.7726	0.4571	0.0570	0.2279	0.1990	0.0706	0.6441	0.3459	0.3732	0.4381	0.0522	0.3825
ROE	R	0.91	1.00	0.04	0.05	-0.06	-0.01	-0.09	-0.08	-0.13	-0.10	0.00	0.00	0.05	0.15	0.04
Return on Equity	<i>P</i>	<.0001		0.4999	0.4634	0.3701	0.9334	0.1649	0.2502	0.0469	0.1186	0.9633	0.9726	0.4560	0.0261	0.4950
SQRT_LR	R	-0.02	0.04	1.00	0.93	0.00	-0.11	-0.02	0.15	-0.06	-0.03	0.18	-0.19	0.05	0.08	-0.03
Square Root of Liquidity Risk	<i>P</i>	0.7372	0.4999		<.0001	0.9494	0.0947	0.8005	0.0247	0.3758	0.6334	0.0070	0.0040	0.4306	0.2508	0.6312
SQRT_CAPRISK	R	-0.02	0.05	0.93	1.00	0.00	-0.10	0.01	0.11	-0.09	0.01	0.14	-0.14	0.00	0.06	-0.04
Square Root of Capital Risk	<i>P</i>	0.7726	0.4634	<.0001		0.9539	0.1198	0.8305	0.0994	0.1776	0.8816	0.0354	0.0293	0.9763	0.3995	0.5269
BS	R	-0.05	-0.06	0.00	0.00	1.00	-0.05	0.54	0.43	0.45	0.22	0.15	-0.17	0.32	0.22	0.28
Board Size	<i>P</i>	0.4571	0.3701	0.9494	0.9539		0.4054	<.0001	<.0001	<.0001	0.0009	0.0260	0.0112	<.0001	0.0006	<.0001
LOG_BM	R	0.12	-0.01	-0.11	-0.10	-0.05	1.00	-0.09	0.02	0.02	0.22	0.00	-0.01	0.04	0.19	0.11
Log of Board Meeting	<i>P</i>	0.0570	0.9334	0.0947	0.1198	0.4054		0.1701	0.7410	0.7224	0.0006	0.9436	0.9366	0.5925	0.0029	0.0937
B_NED	R	-0.08	-0.09	-0.02	0.01	0.54	-0.09	1.00	0.39	0.43	0.16	0.02	-0.01	0.30	0.16	0.23
Proportion of Non-Executive	<i>P</i>	0.2279	0.1649	0.8005	0.8305	<.0001	0.1701		<.0001	<.0001	0.0143	0.7453	0.8997	<.0001	0.0123	0.0003
AC	R	-0.08	-0.08	0.15	0.11	0.43	0.02	0.39	1.00	0.63	0.07	0.29	-0.28	0.18	0.25	0.21
Audit Committee Size	<i>P</i>	0.1990	0.2502	0.0247	0.0994	<.0001	0.7410	<.0001		<.0001	0.3061	<.0001	<.0001	0.0049	<.0001	0.0012
AC_NED	R	-0.12	-0.13	-0.06	-0.09	0.45	0.02	0.43	0.63	1.00	0.28	0.26	-0.25	0.34	0.20	0.33
Audit Committee % of Non-Executive Directors	<i>P</i>	0.0706	0.0469	0.3758	0.1776	<.0001	0.7224	<.0001	<.0001		<.0001	<.0001	0.0001	<.0001	0.0023	<.0001
LOG_ACM	R	-0.03	-0.10	-0.03	0.01	0.22	0.22	0.16	0.07	0.28	1.00	0.04	-0.06	0.22	0.00	0.01
Log of Audit Committee Meeting	<i>P</i>	0.6441	0.1186	0.6334	0.8816	0.0009	0.0006	0.0143	0.3061	<.0001		0.5313	0.3995	0.0007	0.9914	0.8289
SQRT_FF	R	-0.06	0.00	0.18	0.14	0.15	0.00	0.02	0.29	0.26	0.04	1.00	-0.98	0.02	0.06	0.03
Square Root of Free Float	<i>P</i>	0.3459	0.9633	0.0070	0.0354	0.0260	0.9436	0.7453	<.0001	<.0001	0.5313		<.0001	0.7033	0.3801	0.6582
SQ_BH	R	0.06	0.00	-0.19	-0.14	-0.17	-0.01	-0.01	-0.28	-0.25	-0.06	-0.98	1.00	-0.03	-0.06	-0.02
Block Holder Squared/1000	<i>P</i>	0.3732	0.9726	0.0040	0.0293	0.0112	0.9366	0.8997	<.0001	0.0001	0.3995	<.0001		0.6394	0.3714	0.7620
LOG_FIRMAGE	R	0.05	0.05	0.05	0.00	0.32	0.04	0.30	0.18	0.34	0.22	0.02	-0.03	1.00	0.37	0.40
Log of Age of Firm	<i>P</i>	0.4381	0.4560	0.4306	0.9763	<.0001	0.5925	<.0001	0.0049	<.0001	0.0007	0.7033	0.6394		<.0001	<.0001
LOG_GROWTH	R	0.13	0.15	0.08	0.06	0.22	0.19	0.16	0.25	0.20	0.00	0.06	-0.06	0.37	1.00	0.55
Log of Growth	<i>P</i>	0.0522	0.0261	0.2508	0.3995	0.0006	0.0029	0.0123	<.0001	0.0023	0.9914	0.3801	0.3714	<.0001		<.0001
LOG_INTANGIBLE_A	R	0.06	0.04	-0.03	-0.04	0.28	0.11	0.23	0.21	0.33	0.01	0.03	-0.02	0.40	0.55	1.00
+++++++Log	<i>P</i>	0.3825	0.4950	0.6312	0.5269	<.0001	0.0937	0.0003	0.0012	<.0001	0.8289	0.6582	0.7620	<.0001	<.0001	

5.5 Comparing Variables Before and After the Crisis

Independent t-test comparisons are shown on page 195 for the comparisons of variables before and after crisis. It should be noted that two versions of the test are available: One for equal (using pooled variances) and the other for unequal variances (known as Welch's test). In the table, the correct method has been chosen depending on the significance of Levene's test for equality of variances. A result showing significantly different variances (standard deviations) in this test would require the alternative version of the test for unequal variances to be used. The results of these tests have been shaded in grey so they are not confused with the actual significance of the t-tests

In this set of results, there was one significant difference in the mean averages in the analysis variables before and after crisis. This was for Growth that indicated a significant increase after the crisis ($t=2.35$, $p=0.0197$).

There was a general trend for most analysis variables to increase over time. Periods of recession are typically followed by periods of inflation. This effect could explain the increase observed in these variables after the financial crisis. Growth shows an increase (Before mean = 9.92, After mean = 10.93) which could be due to the stabilisation of the financial market coupled with expansion by banks due to there being less competition.

The financial crisis resulted in many smaller banks closing or being absorbed by larger banking institutions. This, in turn, led to there being fewer banks that were larger and richer than before the crisis. For this reason, these larger banks were able to take advantage of their position once the recession began to subside. This may be responsible for the differences observed in growth before and after the recession.

Intangible assets also experienced an increase (Before mean = 6.69, After mean = 7.34). This may be expected due to the influx of cash that was given to banks through bailouts, as well as trust being restored in holding money with banks following the recession.

As banks increased their size following the recession, it is logical that the observed greater board size (Before mean = 12.33, After mean = 12.40) would happen. Linked to this is the increase in the proportion of non-executive directors becoming part of the board (Before mean = 7.53, After mean = 7.88).

Similarly, a higher number of non-executive directors also being absorbed into audit committees was observed (Before mean = 3.80, After mean = 3.91). This was, perhaps, to ensure the adherence to financial reporting, disclosure targets and regulations. This would lead to an increase in the size of such audit committees as is observed in the data.

Return on Assets was found to be close to significance ($t=1.55$, $p=0.1235$). This item increased over time (Before mean=1.60, After mean=2.12). However, the inequality in the variances before and after indicated by the significant Levene test suggests that the effect of the financial crisis on asset returns was not uniform. This reason for this difference can be deduced from the standard deviations. Before the crisis, the standard deviation for ROA was 1.82 while after it was 2.88. This would imply a larger amount of variation in the return of assets after the crisis than before.³

Another comparison close to significance was Audit Committee % of Non-Executive Directors ($t=1.48$, $p=0.1395$). In this comparison, the percentage of non-executive directors had increased after the crisis. (Before mean=3.25, After Mean=3.51).

However, it is noteworthy that one item was an exception and decreased over time. This was Block Holder and this finding would tend to imply that the number of large shareholders decreased after the financial crisis. However, despite this result not being found to be significant ($t=-1.18$, $p=0.2381$) this finding would be expected to be a likely outcome of the financial crisis.

³ Note that the standard deviation is the square root of the variance. Therefore, the standard deviation is a direct measure of variability.

Table 5.4: T-Test Comparisons of Analysis Variables Before and After the Crisis

T-Test Comparisons of Variables Before and After the Crisis

Question	Statistic	Financial Crisis		Degrees of Freedom	t-value	t Probability	Levene Test Significance	Variances
		Before	After					
Return on Assets	Mean	1.60	2.12	142	1.55	0.1235	<.0001	Unequal
	<i>Stan. Dev.</i>	1.82	2.88					
	<i>N</i>	141	94					
Return on Equity	Mean	2.73	3.21	147	1.06	0.2897	<.0001	Unequal
	<i>Stan. Dev.</i>	2.52	3.82					
	<i>N</i>	141	94					
Square Root of Liquidity Risk	Mean	2.78	3.07	233	1.39	0.1673	0.4714	Equal
	<i>Stan. Dev.</i>	1.60	1.50					
	<i>N</i>	141	94					
Square Root of Capital Risk	Mean	2.86	3.04	233	0.88	0.3776	0.5919	Equal
	<i>Stan. Dev.</i>	1.50	1.42					
	<i>N</i>	141	94					
Board Size	Mean	12.33	12.40	233	0.13	0.8986	0.9352	Equal
	<i>Stan. Dev.</i>	4.28	4.25					
	<i>N</i>	141	94					
Log of Board Meeting	Mean	2.28	2.28	233	0.00	0.9977	0.3111	Equal
	<i>Stan. Dev.</i>	0.54	0.59					
	<i>N</i>	141	94					
Proportion of Non-Executive Directors	Mean	7.53	7.88	233	0.87	0.3859	0.1571	Equal
	<i>Stan. Dev.</i>	2.86	3.26					
	<i>N</i>	141	94					

	Mean	3.80	3.91					
Audit Committee	<i>Stan. Dev.</i>	1.26	1.29	233	0.62	0.5375	0.7804	Equal
	<i>N</i>	141	94					
	Mean	3.25	3.51					
Audit Committee % of Non-Executive Directors	<i>Stan. Dev.</i>	1.38	1.19	233	1.48	0.1395	0.1193	Equal
	<i>N</i>	141	94					
	Mean	1.98	2.06					
Log of Audit Committee Meeting	<i>Stan. Dev.</i>	0.68	0.61	233	0.98	0.3281	0.2345	Equal
	<i>N</i>	141	94					
	Mean	5.71	5.89					
Square Root of Free Float	<i>Stan. Dev.</i>	2.19	2.18	233	0.62	0.5365	0.9684	Equal
	<i>N</i>	141	94					
	Mean	4.55	4.11					
Block Holder Squared/1000	<i>Stan. Dev.</i>	2.78	2.86	233	-1.18	0.2381	0.7443	Equal
	<i>N</i>	141	94					
	Mean	3.84	3.95					
Log of Age of Firm	<i>Stan. Dev.</i>	1.17	1.03	233	0.70	0.4855	0.1667	Equal
	<i>N</i>	141	94					
	Mean	9.92	10.93					
Log of Growth	<i>Stan. Dev.</i>	3.79	2.76	231	2.35	0.0197	0.0006	Unequal
	<i>N</i>	141	94					
	Mean	6.69	7.34					
Log of Intangible Assets	<i>Stan. Dev.</i>	3.45	3.27	233	1.45	0.1491	0.5602	Equal
	<i>N</i>	141	94					

5.6 Categorical Variables Before and After the Crisis

The categorical variables used in the analysis were Role Duality (RD), Nomination Committee (NOMC), Remuneration Committee (REC) and Risk Management Committee (RMC). Where these were missing, they were replaced with the mode value (most common of 0 or 1) for the bank depending on whether the missing value was before or after the crisis. If a value was still not present, the mode of all banks was used to replace the missing value.

To determine if there were changes in the percentages of banks that had each item before and after the crisis, chi-square analyses were used. No significant differences were detected using this methodology in the percentage before and after the crisis. Notably though, the test for Role Duality (RD) was close to significance ($\chi^2=2.98$, $p=0.0843$). In this instance, the percentage of RD fell from 14.89% before crisis to 7.45% after crisis.

As banks begin to perform better, it is likely that financial rewards would also begin to increase to pre-recession levels. The outcome of this would be an observable increase in remuneration. As a likely consequence, the number of banks with a Remuneration Committee increased from 44.68% to 51.06%.

Table 5.5: Chi-Square Analysis of Categorical Variables Before and After the Crisis

Chi-Square Analysis of Categorical Variables Before and After Crisis									
Item	Description	Statistic	Before		After		df	χ^2 Value	χ^2 Prob
			No	Yes	No	Yes			
RD	Role Duality	<i>n</i>	120	21	87	7	1	2.98	0.0843
		%	85.11	14.89	92.55	7.45			
NOM C	Nomination Committee	<i>n</i>	84	57	54	40	1	0.11	0.7455
		%	59.57	40.43	57.45	42.55			
REC	Remuneration Committee	<i>n</i>	78	63	46	48	1	0.92	0.3370
		%	55.32	44.68	48.94	51.06			
RMC	Risk Management Committee	<i>n</i>	30	111	16	78	1	0.65	0.4206
		%	21.28	78.72	17.02	82.98			

Note if REC was > 1 it was coded as 1 to create a binary variable.

5.7 Regression Models

Four regression models were created. These modelled ROA, ROE, Liquidity Risk, and Capital Risk. In these models, both the bank and year were used as fixed effects. This was to control for the same banks being included in the data over five different years.

It should be noted that many of the variables were not particularly predictive of the four dependent variables. Therefore, for reasons of consistency and comparability across models, a selection of seven variables was made that was stable over the four models. The continuous independent variables chosen were Log of Growth, Log of Intangible Assets, Board Size (BS), Proportion of Non-Executive Directors (B_NED), Audit Committee Size (AC), and Audit Committee % of Non-Executive Directors (AC_NED).

From the categorical predictors available, it was necessary to choose only two variables to use in the models. This was because these variables were confounded with each other if included together (a combination of these binaries would 100% predict another) and make their parameters inestimable. It was possible to identify through the running of different models that Role Duality (RD) and Remuneration Committee (REC) were the best performing categorical variables for inclusion in the analysis.

The initial preference was to include more independent variables in the model for comparative purposes. However, most possible dependent variables were *very* insignificant in all models. Therefore, a selection of variables was used where the inclusion of an independent variable was based on whether it had indicated close to significance in at least one model.

5.8 Regression Model for Return on Assets

The model of ROA was only one non-control variable was found to be close to significance in the model. This was RD ($f=3.16$, $p=0.0772$). Only the control variable of Bank was found to be significant ($f=1.46$, $p=0.0432$).

Overall, the model indicated an R^2 of 0.33. This suggests that only a moderately successful model was found. However, even where the effect size (R^2) is small, this does not mean that the model is not useful. Instead, the usefulness of the model is dependent on the purpose of the model (Colton and Bower, 2002).

Table 5.6: Model of ROA

Model of ROA. Model $R^2=0.33$, $n=235$

Source	Degrees of Freedom	Type III SS	Mean Square	f Value	f Probability
Log of Growth	1	0.49	0.49	0.10	0.7488
Log of Intangible Assets	1	0.23	0.23	0.05	0.8258
Role Duality (RD)	1	15.17	15.17	3.16	0.0772
Board Size (BS)	1	0.28	0.28	0.06	0.8101
Proportion of Non-Executive Directors (B_NED)	1	5.31	5.31	1.11	0.2946
Audit Committee Size (AC)	1	0.00	0.00	0.00	0.9981
Audit committee of Non-Executive Director % (AC_NED)	1	0.22	0.22	0.05	0.8309
Remuneration Committee (REC)	1	3.62	3.62	0.75	0.3866
Year	4	19.25	4.81	1.00	0.4080
Bank	46	322.44	7.01	1.46	0.0432

Table 5.7: Parameter Estimates

Parameter Estimates (Excluding Control Variables): Model of ROA. $R^2=0.33$, $n=235$

Parameter	Estimate	Standard Error	t Value	Pr > t
Intercept	-1.09	2.25	-0.49	0.6281
Log of Growth	0.03	0.09	0.32	0.7488
Log of Intangible Assets	0.02	0.10	0.22	0.8258
Role Duality (RD)	1.16	0.65	1.78	0.0772
Board Size (BS)	0.02	0.09	0.24	0.8101
Proportion of Non-Executive Directors (B_NED)	0.11	0.10	1.05	0.2946
Audit Committee Size (AC)	0.00	0.25	0.00	0.9981
Audit committee of Non-Executive Director % (AC_NED)	-0.05	0.24	-0.21	0.8309
Remuneration Committee (REC)	0.80	0.92	0.87	0.3866

5.9 Regression Model for Return on Equity

One significant variable was found in the model for ROE. This was Role Duality (RD) ($f=5.23$, $p=0.0234$). All other independent variables within the model were determined to be non-significant. In this instance, the control variable of year was also shown to be non-significant ($f=1.31$, $p=0.1089$).

Table 5.8: Model of ROE

Model of ROE. Model $R^2=0.31$, $n=235$

Source	Degrees of Freedom	Type II SS	Mean Square	f Value	f Probability
Log of Growth	1	7.44	7.44	0.84	0.3593
Log of Intangible Assets	1	1.45	1.45	0.16	0.6854
Role Duality (RD)	1	46.08	46.08	5.23	0.0234
Board Size (BS)	1	1.91	1.91	0.22	0.6424
Proportion of Non-Executive Directors (B_NED)	1	4.18	4.18	0.47	0.4922
Audit Committee Size (AC)	1	0.57	0.57	0.07	0.7989
Audit committee of Non-Executive Director % (AC_NED)	1	1.25	1.25	0.14	0.7075
Remuneration Committee (REC)	1	2.55	2.55	0.29	0.5912
Year	4	30.27	7.57	0.86	0.4901
Bank	46	531.88	11.56	1.31	0.1089

Table 5.9: Parameter Estimates

Parameter Estimates (Excluding Control Variables): Model of ROE. $R^2=0.31$, $n=235$

Parameter	Estimate	Standard Error	t Value	Pr > t
Intercept	-1.69	3.04	-0.56	0.5784
Log of Growth	0.11	0.12	0.92	0.3593
Log of Intangible Assets	-0.06	0.14	-0.41	0.6854
Role Duality (RD)	2.02	0.88	2.29	0.0234
Board Size (BS)	0.06	0.12	0.47	0.6424
Proportion of Non-Executive Directors (B_NED)	0.09	0.14	0.69	0.4922
Audit Committee Size (AC)	0.09	0.34	0.26	0.7989
Audit committee of Non-Executive Director % (AC_NED)	-0.12	0.33	-0.38	0.7075
Remuneration Committee (REC)	0.67	1.25	0.54	0.5912

5.10 Regression Model for Liquidity Risk (Square Root)

The model of Liquidity Risk was much more successful than the models for ROA and ROE. Overall, the model was a good predictor of Liquidity Risk with an R^2 of 0.66.

Log Growth ($f=5.91$, $p=0.0161$), Audit Committee Size ($f=24.06$, $p<.0001$), Audit Committee % of Non-Executive Directors ($f=8.80$, $p=0.0055$) and the control variable of Bank ($f=6.36$, $p<.0001$) were all found to be significant.

Log of Intangible Assets was also found to be close to significance ($f=3.22$, $p=0.0744$) as was Proportion of Non-Executive Directors ($f=3.19$, $p=0.0760$) and Remuneration Committee ($f=3.45$, $p=0.0649$). Board Size ($f=0.27$, $p=0.6021$) and Role Duality ($f=2.43$, $p=0.1210$) were, however, not found to be significant.

Table 5.10: Model of Liquidity Risk (Square Root)**Model of Liquidity Risk (Square Root). Model $R^2=0.66$, $n=235$**

Source	Degrees of Freedom	Type II SS	Mean Square	f Value	f Probability
Log of Growth	1	6.58	6.58	5.91	0.0161
Log of Intangible Assets	1	3.59	3.59	3.22	0.0744
Role Duality (RD)	1	2.71	2.71	2.43	0.1210
Board Size (BS)	1	0.30	0.30	0.27	0.6021
Proportion of Non-Executive Directors (B_NED)	1	3.55	3.55	3.19	0.0760
Audit Committee Size (AC)	1	26.83	26.83	24.06	<.0001
Audit committee of Non-Executive Director % (AC_NED)	1	8.80	8.80	7.89	0.0055
Remuneration Committee (REC)	1	3.85	3.85	3.45	0.0649
Year	4	5.77	1.44	1.29	0.2742
Bank	46	326.03	7.09	6.36	<.0001

Table 5.11: Parameter Estimates (Excluding Control Variables): Model of Liquidity Risk (Square Root)**Parameter Estimates (Excluding Control Variables): Model of Liquidity Risk (Square Root). $R^2=0.66$, $n=235$**

Parameter	Estimate	Standard Error	t Value	Pr > t
Intercept	-0.30	1.08	-0.28	0.7812
Log of Growth	0.10	0.04	2.43	0.0161
Log of Intangible Assets	-0.09	0.05	-1.79	0.0744
Role Duality (RD)	0.49	0.31	1.56	0.1210
Board Size (BS)	0.02	0.04	0.52	0.6021
Proportion of Non-Executive Directors (B_NED)	-0.09	0.05	-1.78	0.0760
Audit Committee Size (AC)	0.59	0.12	4.91	<.0001
Audit committee of Non-Executive Director % (AC_NED)	-0.33	0.12	-2.81	0.0055
Remuneration Committee (REC)	0.83	0.44	1.86	0.0649

5.11 Regression Model for Capital Risk (Square Root)

Similar to the model of Liquidity Risk, the model for Capital Risk was successful with an R^2 of 0.67. There were several significant independent variables in the model. Log Growth ($f=6.93$, $p=0.0092$), Log of Intangible Assets ($f=5.10$, $p=0.0252$), Audit Committee Size ($f=22.70$, $p<.0001$), Audit Committee % of Non-Executive Directors ($f=11.24$, $p=0.0010$) and the control variable of Bank ($f=6.97$, $p<.0001$) were all found to be significant. However, the Proportion of Non-Executive Directors ($f=3.12$, $p=0.1166$) and Board Size ($f=2.05$, $p=0.1542$) were found to be non-significant in this model.

Table 5.12: Model of Capital Risk (Square Root)

Model of Capital Risk (Square Root). Model $R^2=0.67$, $n=235$

Source	Degrees of Freedom	Type II SS	Mean Square	f Value	f Probability
Log of Growth	1	6.53	6.53	6.93	0.0092
Log of Intangible Assets	1	4.80	4.80	5.10	0.0252
Role Duality (RD)	1	1.55	1.55	1.64	0.2016
Board Size (BS)	1	1.93	1.93	2.05	0.1542
Proportion of Non-Executive Directors (B_NED)	1	2.34	2.34	2.49	0.1166
Audit Committee Size (AC)	1	21.38	21.38	22.70	<.0001
Audit committee of Non-Executive Director % (AC_NED)	1	10.58	10.58	11.24	0.0010
Remuneration Committee (REC)	1	0.46	0.46	0.49	0.4870
Year	4	4.28	1.07	1.14	0.3412
Bank	46	302.20	6.57	6.97	<.0001

Table 5.13: Parameter Estimates (Excluding Control Variables): Model of Capital Risk (Square Root)

Parameter Estimates (Excluding Control Variables): Model of Capital Risk (Square Root). $R^2=0.67$, $n=235$

Parameter	Estimate	Standard Error	t Value	Pr > t
Intercept	0.06	0.99	0.06	0.9494
Log of Growth	0.10	0.04	2.63	0.0092
Log of Intangible Assets	-0.10	0.04	-2.26	0.0252
Role Duality (RD)	0.37	0.29	1.28	0.2016
Board Size (BS)	0.06	0.04	1.43	0.1542
Proportion of Non-Executive Directors (B_NED)	-0.07	0.04	-1.58	0.1166
Audit Committee Size (AC)	0.53	0.11	4.76	<.0001
Audit committee of Non-Executive Director % (AC_NED)	-0.36	0.11	-3.35	0.0010
Remuneration Committee (REC)	0.28	0.41	0.70	0.4870

5.12 Interpretation and Discussion

5.12.1 Effect of Variables on Performance as measured by ROA and ROE

There is no significant negative link between BS and corporate performance in either the ROA or ROE models. Therefore, these results indicate that hypothesis H1a can be rejected. Notably, BS showed a small positive effect on corporate performance in the parameter estimates. This means that there was a small but not significant tendency for a larger BS to indicate better corporate performance.

This finding is in contrast to other studies where larger boards have been associated with poorer performance. Haniffa (2006) stated that large boards are detrimental to an organisations' performance. Similarly, studies by Hermalin and Weisbach (2003), Lipton and Lorsch (1992), Pathan and Faff (2013), Yermack (1996), and Fairchild and Li (2005) suggest that the larger the size of the board the more likely that firm performance will decrease.

The rejection of hypothesis H1a is in line with work by Hussainey & Walker (2009), in which it was shown that Board Size has a significant positive effect to performance, larger boards allowing firms to be in a better position to finance their activities, consistent with the fact that a higher quality of corporate governance can increase an organisation's performance.

In contrast, Coles (2008) argued that as Board Size increases, performance also increases. Coles contended that larger boards are more likely to contain a more diverse range of people. This, theoretically, equates to more knowledge, which should be beneficial to performance. Moreover, this should also result in a substantially lower chance of any knowledge gaps occurring. In effect, this should allow efficient and strategic decisions to be made with confidence.

Concerning Role Duality and performance measured by ROA and ROE, Hypothesis H2a can be accepted, as there is a positive relationship between role duality and performance (significant in the case of ROE and almost significant in the case of ROA).

In concurrence with these findings, Boyd (1995) argued that role duality allows for the creation and rise of a powerful leader that results in benefits such as stability and decreased risk, which in turn can lead to an increase in performance.

Another finding from the ROA and ROE models that there was no positive significant link between the number of non-executive directors and corporate performance, Hypothesis H3a can be rejected.

There is a paucity of research in the relationship between corporate performance and the number of NEDs. However, work by Adams (2012) indicated that non-executive directors' input is potentially beneficial to a board. That said, he did not provide sufficient information to determine the effect on performance.

In respect of both ROA and ROE, Hypothesis H4a, regarding the size of the Audit Committee and Corporate Performance, can be rejected. Here, the results attained do not show a positive significant link between the size of the audit committee and ROA or ROE.

This finding is supported by the research by Vefas (1999) who found that AC size has no effect on performance. However, this is contradicted by Engel (2009) who stated that AC size has a positive effect on performance. He also found that this might be via indirect methods such as transparency that increased a company's reputation.

There was no positive significant link regarding the non-executive directors' proportion on the Audit Committee and Corporate Performance observed in either the ROA or ROE models. Therefore, Hypothesis H5a is rejected.

The finding that there was no positive significant link regarding the proportion of NEDs on the Audit Committee and Corporate Performance contradicts the outcomes of previous

studies. Cadbury (1992) found that an AC consisting entirely of NEDs acts to increase accountability and responsibility, thereby leading to enhanced performance by proxy.

Hypothesis H6a is also rejected in both the ROA and ROE models as the results show that there is neither a significant nor a negative relation between the existence of a remuneration committee and corporate performance.

This finding is supported by Ezzamel (1997), who stated that remuneration has no effect on corporate performance. Moreover, there is no causal negative relationship inferred by Ezzamel. It is simply that no relationship exists. Ezzamel labelled the relationship as 'inconsequential' to performance.

However, other research has found there to be a positive relationship between remuneration and performance (Chi Kun Ho, 2005). Notably, the results of ROA and ROE in the current study did find a positive impact of the presence of a Remuneration Committee (rather than remuneration exclusively), albeit not a significant one, in line with the findings of Chi Kun Ho.

5.13 Effect of Variables on Risk as measured by LR and Carisk

Board Size was not significant in the Liquidity Risk model or the Capital Risk model. These findings indicate that Hypothesis H1b can be rejected. In both models, the parameter value was also barely positive indicating that there is no clear directional association between Board Size and corporate risk. This is in contrast to other studies such as that of Adam (2003), who found a negative relationship between Board Size and Risk.

Hussainey (2012) supports this study's rejection of Hypothesis H1b, as he states that corporate governance, when concerning Board Size, does not have an influence on risk.

There was no significant relationship observed between Role Duality and Corporate Risk in either the Liquidity Risk or the Capital Risk models. For this reason, Hypothesis H2b can be rejected.

It is arguable that if a substantial relationship existed between Role Duality and Corporate Risk, there would be research to support this position. However, there is no literature available to support any position concerning the relationship between Role Duality and Corporate Risk. Therefore, it is difficult to surmise if there should be a relationship between Role Duality and Corporate Risk, and what that relationship would typically display.

It should be noted that in these two models, Role Duality was modelled as a binary variable where the presence of Role Duality rather than the extent of Role Duality was modelled. It is possible that better data regarding the extent of Role Duality could illuminate whether a relationship existed and, if so, whether the extent of Role Duality had an effect on risk and whether the effect was to increase or decrease it.

The number of NEDs and Corporate Risk indicated negative parameters (increased risk aversion where more NEDs were present). This relationship (albeit not significant) was found with respect to Liquidity Risk and Capital Risk, indicating that Hypothesis H3b is tentatively, though not conclusively accepted. However, similar to Role Duality, there is no literature available regarding NEDs that these results can be compared against in order to contextualise them.

Hussainy (2013) states that banks with a higher proportion of NEDs within their boards tend to have a higher risk associated with them, reflected in our study by the positive, close to significant result gained in this regard pertaining to Liquidity Risk.

There was a significant relationship between the size of the Audit Committee and Corporate Risk found in both the Liquidity Risk and Capital Risk models, where it was seen that the larger the size of the audit committee, the greater the level of risk. Therefore, Hypothesis H4b can be rejected.

This finding is in contrast to Engel (2009) who stated that the size of an AC could either have no impact at all on corporate risk or cause a decrease in risk exposure.

There was a significant relationship between the proportion of NEDs on an AC and Corporate Risk in both the Liquidity Risk and Capital Risk models. The negative parameter estimates in these models indicated that as the proportion of NEDs increased, the exposure to risk decreased. Therefore, Hypothesis H5b is accepted.

This finding is in line of the work of Engel (1999), where they stated that the AC positively increases the chance of fair and transparent practices to be prevalent within a firm.

An increase in exposure to risk was observed between the existence of a Remuneration Committee and Corporate Risk in both the Liquidity Risk and Capital Risk models. The presence of a Remuneration Committee was almost significant in the Capital Risk model but not in the Liquidity Risk model despite being positive in both (indicating the presence of a committee increased risk exposure). Therefore, Hypothesis H6b is accepted tentatively though not conclusively.

Research by Laing (1999) suggests that a risk-averse relationship exists between corporate risk and remuneration. They state that, as remuneration increases, performance also increases whilst at the same time risk decreases (Laing, 1999).

5.14 Discussion in the Lights of Theories

Entitled the Role of Corporate Governance in Enhancing Performance and Reducing Corporate Risk: The Case of the UK Banking Sector between 2006 and 2010, this study concludes that there is significant evidence that corporate governance enhances performance and reduces corporate risk. The findings indicate that out of six independent variables used in the regression analyses, there were statistically significant and no significant relationships between corporate performance or corporate risk. Several studies have been conducted focusing on the relationship between bank performance tools with respect to corporate governance frameworks but with conflicting results. This study has concentrated on the influence of corporate governance with respect to bank performance and corporate risk in the UK banking sector, providing results that may be of interest to regulators as they suggest the need for bank regulation, especially in the context of corporate governance. This would essentially work to balance the interests of shareholders, board directors, and executives.

Although research in this particular field has experienced maturation during the last two decades, the significant weakness in the global attention to corporate governance appears to be the dominant focus on, and orientation towards, the United States. Hence, the US institutional context features as the unit of analysis in the vast majority of research studies. Very few cross-national studies have been undertaken, and even in single country studies, the findings have been to be sufficiently ambiguous to demonstrate that generalisations from the US are invalid in European contexts. This study focuses on the banking sector in the single country of the United Kingdom, which enhances the contribution of this piece of research to the overall body of literature on corporate governance. By achieving its objectives, this study has been able to significantly add to the existing literature pertaining to the banking sector. The extensive literature review has provided an in-depth knowledge about the evolution of corporate governance and its application to listed companies in the United Kingdom. And the empirical work has explored the role and impact of corporate governance mechanisms like board size, role duality, audit committee size, proportion of non-executive directors, and remuneration committee on bank performance and risk. To the best knowledge of the researcher, studies focusing on the influence of such initiatives on the risk management of listed corporations, particular banks, are limited. This study, therefore, represents a novel attempt in this respect, by evaluating this issue with respect to the capital and liquidity risk of banking companies, and it has subsequently added to the knowledge in this field.

With regard to board size, the analysis of the data collected indicates there to be a positive non-significant link between Board Size and bank performance. However, this positive regression result may be considered negligible because the ROE of a company is subject to the influence of several other factors. It is necessary to consider the prior finding of Gompers et al. (2003) that firms with better governance practices in place were able to command better valuation and exhibit better operating performance. Gompers et al. (2003) also found corporate governance to be an insignificant factor in explaining ROE. There are several arguments regarding Board Size and its influence on firm performance as measured by ROE and ROA, but the empirical findings from this study reveal an inverse relationship between Board Size and Capital Risk.

Based on these findings, this study concludes that Board Size, as an integral component of the overall corporate governance machine, must be considered carefully by the management. The effect of Board Size on corporate performance cannot be ignored. Although prior studies have indicated that larger boards are much less efficient than smaller boards, because of the tendency of large boards to encourage the domination and the widening of the firm's discretionary power, the diverse opinions that a company can secure from greater membership can greatly assist in decision-making, and this known advantage cannot be ignored. That said, large boards are also criticised on the grounds that it costs more for the company to ensure proper communication and co-ordination of them, and that they invariably lead to delays in decision-making compared to small boards. However, this study suggests that the nature and size of the business must be the factors affecting Board Size, as the number of directors required and their expected contribution may vary depending on these factors. In large businesses of a complex nature, there might be the real necessity to have a large board to guide the company in the proper direction. On the other hand, a small company with a less complex business may fare well with a small board.

With respect to the promotion of NEDs, the regression coefficient for this variable is negative but not significant for ROA and ROE.

Despite these findings, this study supports the participation of more external directors because NEDs can bring expertise to the board and thus ensure effective board monitoring and firm performance. In some cases, these external directors may also add to the reputation of the companies. Especially in banking companies, the board should have the capability to assess the risk facing the banks. This requires additional knowledge about the micro and macroeconomic situations that are likely to affect the business of the banks. Such intelligence can be brought into the bank by external NEDs. However, the study asserts that the amount of participation by NEDs is also dependent on the magnitude and type of business conducted by the company. Indeed, the company may decide on the proportion

of NEDs depending on the complexities and dimensions of its business problems, which are bound to vary depending on the nature of the business involved.

This study found that while considering the question of role duality, agency theory supports the act of separating the responsibility of the CEO from that of the board chairperson. Stewardship theory, on the other hand, supports the notion of role duality claiming that it enhances company performance in terms of improved ROA and ROE. According to stewardship theory, role duality is regarded as a significant boost to organisational performance because there is unified command. The same is evident by the practices of some organisations in the developed nations. In this context, the findings from the regression analysis show an inverse relationship between role duality and corporate performance, and an inverse relationship between role duality and corporate risk. In cases where the CEO of an organisation also assumes the role of board chairperson, there is a chance that the company is subjected to higher liquidity and capital risks. This study considers role duality to positively influence the financial performance of the corporations because of the informal power provided to the CEO holding the position of the board chairperson, who can influence the decisions of the board by virtue of his/her vested powers. Role duality is shown to bring with it the possibility of fraud or misuse of company finance as that power and authority become concentrated in one pair of hands. The separation of the roles of chairperson and CEO, in light of the theory of agency, is supported by the research outcomes. They argue for more independent supervision and management as this is likely to result in higher profitability for the firms. In a competitive business environment like that of a bank, the separation of these roles is vital, because it is the job of the chairman to be able to accurately understand, plan and implement strategies, in full knowledge of the associated risks. The day-to-day operations of the bank may be conducted by the CEO under the strategic guidance of the chairperson. The chairperson may also be responsible for devising strategies that will manage and dilute risks and resultantly, lead to the company earning more profits, rather than simply remaining afloat. Additionally, that individual will be able to monitor the working of the board together with the CEO to achieve the established strategic goals.

With respect to the fundamentals of the agency model, Hawley and Williams (1996) state that, "in the finance view, the central problem in corporate governance is to construct rules and incentives (that is, implicit or explicit 'contracts') to effectively align the behavior of managers (agents) with the desires of principals (owners)" (pp. 21). Thus, the agency model is based on the relational dynamics of stakeholders with the firm. The major assumption that dictates the agency theory is the ownership of the corporations being dispersed as seen with respect to the 'modern' corporations of the United States. One of many consequences of such a dispersed ownership assumption is the existence of a gap between the owners, representing the 'principals' of the firm, and the persons in charge of managing

the daily affairs pertaining the company, known as the 'agents'. Because of this gap, governance issues arise when the principals who are interested in maximizing their investments start to monitor the agents. The agents, on the other hand, might have an inclination to work towards enhancing their personal wealth. Jensen and Meckling (1976) help further outline that link, since the relationship pertaining to rights of ownership and management in a corporation represents that of a typical agency; the resulting issues linked with separating the ownership from control are also mostly agency-based.

In the context of board committees, audit committees can be considered an additional control mechanism that protects the interests of the shareholders. Many researchers have cited the internal control oversight duties of audit committees, emphasising the importance of the role of audit committees in establishing the credibility and reliability of the firm's internal control systems and the investment decisions of the investors. The findings of this study show that the association with audit committee size is negative and non-significant for both ROA and ROE. A negative association between dependent and independent variables was noted with respect to the NED-percentage on the audit committees. On the question of the relationship between ACs and corporate risk, this study hypothesised that there exists an inverse association between AC size and corporate risk. The study's findings clarified that the number of members on the AC has a significant effect on the liquidity and capital risks of firms because of the passive relationship between the two variables as supported by the agency theory. The agency theory places the onus of reporting the conduct of company affairs to the shareholders, on the board and managers, emphasising the benefit of including representatives of shareholders on the various board committees. The findings that the study stipulates the significance of different stakeholders in the corporate governance board, which is needed to improve the company's performance and increase its value, while at the same time, decreasing risks and fraudulent activities and protecting the rights of different stakeholders and benefitting them. The stakeholder theory asserts that the stakeholders work in the society, where it operates and therefore, it provides legal frameworks and market trends to the company. The findings of the study suggests that the corporate governance system comprises of board members, external directors and shareholders and can help in reducing the level of risks and corporate fraudulent activities significantly. Under the stakeholder model, the company focuses on providing services to its customers. Although corporate governance system helps in improving the value of the firm and increases its revenues, the study does not indicate whether profit maximization is the ultimate aim of the UK banks in the banking industry, which is supported by the stakeholder theory. However, the findings of the research suggest that board committees, external directors and shareholders have important relationship and can affect the efficiency of the corporate governance system.

It was hypothesized in the study that a positive relationship exists between the existence of a Remuneration Committee and Corporate Performance. Hence, this outcome supports the contentions of the agency, stakeholder, and stewardship theories, as it testifies to the role of board committees as being responsible for the oversight function of the board, and accountable to the shareholders for their actions in this respect. All these committees function to reduce the agency problems and maximise the value to the shareholders. Hence, this study recommends the formation of board committees, suggesting at the same time, that for their effectiveness, such committees must recruit talented individuals as members, and enjoy independence in helping the board to take decisions rather than simply endorsing the decisions of the managers or other directors.

5.15 Conclusion

The four regression models show that the different variables have either a negative or positive relationship pertaining to corporate performance or risk. The aim here was to determine the influence of corporate governance on performance and corporate risk. The results from the models show that certain variables have a positive influence on performance whilst others do not. With regards to performance, in respect of ROA and ROE, all independent variables expressed a slightly positive relationship. However, all of these variables except for Role Duality were found to be non-significant.

The regression model for Liquidity Risk shows a definitive positive relationship between all of the concerned independent variables, with only Board Size and Role Duality showing non-significance here. This means that the effects of these two variables on risk, if they arise, have a high probability of being due to chance and are not caused by the effects of their respective fluctuations. As log Growth, Audit Committee Size, and % of non-executive directors within the Audit Committee all express significance, the changes will be expressed in a directly proportional manner with regard to Corporate Risk. The same can be said, to a lesser extent, for the proportion of NEDs and Remuneration as they reflect results that are close to significance.

For the Capital Risk regression model, a positive relationship to Corporate Risk was observed, with all independent variables showing definitive significance with the exception of NEDs and Board Size, where there was no significance.

The results of the study suggest that corporate governance is critical in enhancing the overall performance of the organisation as well as managing risk.

It can be concluded from the above that Corporate Risk is affected by many more independent variables than Corporate Performance, meaning that Risk is much more likely to show changes, be they increases or decreases, than the level of performance of an organisation such as a bank.

As can be seen, some variables had to be dropped before the regression analysis as they were not significant, and if included may have compromised the integrity of the model.

The limitation of the study in this regard includes unaccounted for variation, which was incapable of being determined or predicted.

From a statistical standpoint, limitations exist in the form of the inherent lack of predictability of R^2 that are less than 1, and the fact that a substantial amount of data was missing and so had to be compensated for through imputation.

Chapter 6: Survey Response Analysis

6.1 Introduction

The goal of this chapter is to analyse the primary data collected, using the questionnaire that had been adopted to investigate the significance of corporate governance and the issues surrounding it. The primary data collected with the help of questionnaire, which had been distributed among 480 bankers and 450 brokers, had been sampled and analysed statistically to draw inferences. The results obtained from the questionnaire have been discussed in this section. The factors investigated were board size, role duality, NEDs, board meetings, AC size, ACs, free float, nominations committee, remunerations committee, risk management committee, and block-holders. Using these variables, it is possible to see how they impact upon corporate risk, and ultimately corporate performance. This chapter also compares and discusses the results of the empirical investigation with that to the questionnaire.

6.2 Overview

The purpose of using purposive sampling was to select the individuals that were bankers and brokers since the study aimed at investigating the impact of corporate governance on banks performance and corporate risk and since, they are associated with the banking industry (Gilley et al., 2002, Bhattacharya and Thakor, 1993, Montgomery and Curotto, 2009, Denise and Cruse, 2002). Once the list of bankers and brokers had been compiled by the researcher, the researcher invited the bankers and brokers to take part in the research, explained to them the research aim and objectives and invitation to take part in the research. The researcher had emailed the questionnaire with the consent form to the bankers and brokers. The researcher waited for a period of two weeks to get the responses from the bankers and brokers. When the researcher did not get the response, she had sent an email reminder to the targeted samples. A total of 480 questionnaires were sent to the bankers and 450 questionnaires through brokers. The researcher got 200 complete surveys from bankers and 185 questionnaires from the bankers. A total of 147 complete questionnaires were selected from the bankers sample and 156 from the brokers sample since 53 questionnaires from the bankers and 38 questionnaires from brokers contained incomplete information. Consequently, the final sample size consisted of 147 and 156 complete questionnaires from bankers and brokers respectively

6.3 The Survey Instrument, Response, Demographics, and Descriptive Statistics

The questionnaire contained twenty-eight questions, thirteen of which related to corporate performance, and fifteen to corporate risk. The questions included perceptions of initiatives to enhance profitability, and their impact on reducing the capital and liquidity risk of banks. Through these questions, the perceived effectiveness of the different corporate governance initiatives regarding performance and risk was identified, such effectiveness being measured by board size and membership, the presence of an AC, role duality, and the number of times the board and AC have their respective meetings.

Copies of the survey were posted to two groups of respondents: bankers and brokers. A total of 303 responses was received consisting of 147 responses from bankers, and 156 from brokers. Table 6.1 indicates the overall response rate as being 32.6%, with brokers' response being slightly higher than that for bankers (34.7% brokers, 30.6% bankers). This response rate is quite high, but similar studies in other countries have reported much higher rates. For example, a corporate governance study in Uganda reported a response rate of 75% (Rogers, 2008) while a study of firm performance in Kenya reported a response rate of 78% (Ogotu et al., 2011). However, these response rates from Africa may not be comparable to those from the UK, because of cultural differences.

Table 6.1: Survey Response Rates

Group	Number of Questionnaires Sent	Number of Responses Received	Response Rate Percentage
Bankers	480	147	30.6%
Brokers	450	156	34.7%
Overall	930	303	32.6%

In respect of the demographics of the sample, Table 6.2 shows these, revealing that brokers comprised 51.49% of the sample, and bankers remaining 48.51%. Nearly two-thirds of respondents (65.68%) held a Bachelor's degree, 29.70% held a Master's Degree, and 4.62% were educated to PhD level. Most respondents had worked in banking for at least ten years (81.21%), with 32.67% having done so for more than 20 years. The most common age group was that including individuals aged 36 to 45 (49.83%). Overall, 66.3% of respondents were male, and 33.7% female. Whilst there is a clear imbalance in gender terms, the distribution of the sample may indicate the increasing role of women in management in the UK.

Table 6.2: Demographic Characteristics of the Sample

Demographic Characteristics of Respondents			
Response	<i>n</i>	%	
Age Group			
Aged 25 to 35	70	23.10	
Aged 36 to 45	151	49.83	
Aged Over 45	82	27.06	
Total	303	99.99	
Gender			
Male	201	66.34	
Female	102	33.66	
Total	303	100.00	
Highest Education Level			
Bachelor degree	199	65.68	
Master's degree	90	29.70	
PhD or Post doctorate	14	4.62	
Total	303	100.00	
Industry Sector			
Banker	147	48.51	
Broker	156	51.49	
Total	303	100.00	
Years of Experience			
Less than 5 years	15	4.95	
5 to 10 years	41	13.53	
10 to 20 years	148	48.84	
More than 20 years	99	32.67	
Total	303	99.99	

Descriptive statistics, including means, standard deviations, medians, minimum and maximum values, and normality tests are presented in Tables 6.3 and 6.4.

Some questions did not indicate a great deal of variation in responses. For example, there were questions where only two of the available response categories had been used by participants. Hence, it was not expected to find a normal distribution in these instances.

Kolmogorov-Smirnov tests of normality were used in this respect (indicated in the tables). A significant result from the Kolmogorov-Smirnov indicates a non-normal distribution. However, it should be noted that this test is very conservative and likely to indicate non-normality (Steinskog et al., 2007).⁴

In fact, all the tests conducted were shown to be significant, thereby indicating non-normal distributions. For these reasons, non-parametric statistics that do not assume distributional normality were used to analyse the survey questions.

⁴ Steinskog DJ, Tjostheim DB, and Kvamsto NG, A cautionary note on the use of the Kolmogorov-Smirnov test for normality. American Meteor Soc. 2007;135:1151–7. See: http://folk.uib.no/ngbnk/Publications/Steinskog_etal_MWR_07.pdf

Table 6.3: Corporate Performance Questions: Descriptive Statistics**Corporate Performance Questions: Descriptive Statistics and Tests for Normality (n=303)**

Question	Mean	Std Dev	Median	Sum	Minimum	Maximum	Kolmogorov-Smirnov D	Kolmogorov-Smirnov p
Q1. The increase in shares that are freely available to the investing public is positively related to good corporate performance.	4.52	0.62	5	1,371	3	5	0.37	<.0001
Q2. Separating positions of chairperson and CEO has a positive effect on performance.	4.69	0.60	5	1,420	2	5	0.43	<.0001
Q3. Corporate governance enhances the managing body's ability to perform by connecting executive remuneration with finance led conclusions.	4.06	0.42	4	1,230	3	5	0.44	<.0001
Q4. Improving corporate governance improves answerability through frequent meetings of audit committee	4.15	0.67	4	1,257	2	5	0.34	<.0001
Q5. The increase in nomination Committee affects corporate performance in a positive way.	3.03	0.69	3	918	2	4	0.26	<.0001
Q6. Frequent meetings of the Nomination committee have a positive effect on corporate performance.	3.26	0.63	3	987	2	4	0.30	<.0001
Q7. A large audit committee can facilitate effective monitoring.	3.19	0.73	3	968	1	4	0.25	<.0001
Q8. A high percentage of independent non-executive directors in the nomination committee have a positive impact on corporate performance.	3.71	0.50	4	1,124	2	4	0.45	<.0001
Q9. The existence of many shareholders with an exceptionally large amount or value of stock sustains a good corporate governance system.	3.90	0.41	4	1,181	2	5	0.51	<.0001
Q10. Large sized boards are impediments to good performance.	3.38	0.69	3	1,024	2	5	0.34	<.0001
Q11. Increasing the number of non-executive directors is helpful to a firm's management.	3.36	0.61	3	1,019	2	5	0.34	<.0001
Q12. Frequent board meetings allow good monitoring and smooth management of a firm.	3.86	0.63	4	1,171	3	5	0.31	<.0001
Q13. An audit committee should contain a high ratio of non-executive directors.	4.28	0.66	4	1,296	3	5	0.27	<.0001

Table 6.4: Corporate Risk Questions: Descriptive Statistics

Corporate Risk Questions: Descriptive Statistics and Tests for Normality (n=303)

Question	Mean	Std Dev	Median	Sum	Minimum	Maximum	Kolmogorov-Smirnov D	Kolmogorov-Smirnov p
Q14. The Audit Committee should ensure that the primary objectives and functions of the Risk management Committee are adequately and effectively	4.09	0.71	4	1,240	1	5	0.40	<.0001
Q15. Government owned companies don't rely on managing risk that much since the Government almost never defaults	1.24	0.68	1	377	1	5	0.47	<.0001
Q16. An audit committee member must understand how the company's liquidity is being managed.	4.05	0.53	4	1,226	3	5	0.37	<.0001
Q17. A good corporate governance system ensures that the BOD's have sufficient information to make sound decisions on important matters such	4.12	0.39	4	1,247	3	5	0.48	<.0001
Q18. The type of the shareholder affects consequences of corporate capital risk.	4.02	0.73	4	1,219	3	5	0.24	<.0001
Q19. Board of Directors should develop a liquidity strategy consistent with the strategic objectives of the financial institution as a whole	4.17	0.38	4	1,265	4	5	0.50	<.0001
Q20. Systematic liquidity risk increases with institutional ownership.	3.39	0.49	3	1,028	3	4	0.40	<.0001
Q21. Consideration of the most relevant company structure in managing risk related errors at the board level.	4.16	0.37	4	1,261	4	5	0.51	<.0001
Q22. Institutional owners exert a significant influence on risk management committee.	4.02	0.34	4	1,219	3	5	0.46	<.0001
Q23. The AC can understand the company's capital structure along with subsequent risks.	4.12	0.32	4	1,247	4	5	0.53	<.0001
Q24. The measurements of liquidity risk to be forwarded to the BODs, for monitoring the liquidity portfolio along with compliance with what is required by the government along with the yearly business plan	3.95	0.48	4	1,198	2	5	0.45	<.0001
Q25. An audit committee should make sure that management attempts to avoid the negative consequences of risk.	4.02	0.40	4	1,219	3	5	0.43	<.0001
Q26. An audit committee should ensure that all corporate objectives are adequately mapped against risk.	4.02	0.46	4	1,219	3	5	0.40	<.0001

Q27. The degree of ownership concentration has a considerable impact on the behaviour of risk management committee.

4.56 0.82 5 1,381 2 5 0.40 <.0001

6.4 Hypotheses Testing

Statistical testing was conducted to determine whether any significant differences existed between bankers and brokers in their responses to the questionnaire statements. Specifically, the hypotheses related to whether these two populations differed in their views regarding corporate governance and corporate risk. The hypotheses tested are formally stated as:

Hypothesis 1: Corporate Performance

H0: There are no differences between bankers and brokers in their views regarding Corporate Performance

H1: There are differences between bankers and brokers in their views regarding Corporate Performance

Hypothesis 2: Corporate Risk

H0: There are no differences between bankers and brokers in their views regarding Corporate Risk

H1: There are differences between bankers and brokers in their views regarding Corporate Risk

6.4.1 Statistical Methodology

Mann-Whitney U tests (the non-parametric equivalent of t-tests based on Wilcoxon scores) were used in the following analyses. Unlike means and standard deviations, which can be used to compare two independent samples, non-parametric tests (such as the Mann-Whitney U test) are based on testing differences in ranks, and therefore, they do not depend on normality.

The statistic used to determine significance is a normal approximation based on Z-values, preferred over the approximation to the *t*-distribution as the two samples are greater than $n=30$. Therefore, if the responses are sampled using a continuous variable, these would tend (theoretically) towards a normal distribution due to the Central Limit Theorem (Yates et al., 1999). However, the decision to use the Z-statistic in this instance is based on sample size rather than any distributional consideration, as the tests are non-parametric and based on ranks.

6.4.2 Corporate Governance and Performance

Table 6.5 presents the first 13 questions relating to corporate performance. Statistical significance is indicated by the use of asterisks as well as p -values. One asterisk indicates significance at the $p \leq 0.05$ level, two indicate significance at the $p \leq 0.01$ level, and three indicate significance at the $p \leq 0.001$ level.

On almost all items, there are significant differences between the bankers and the brokers in their views. However, the degree of difference in both size and direction, varies greatly depending on the statements.

Despite the use of non-parametric, the mean average value is quoted in these results and used in the charts. This makes it easier to follow the results (in terms of one level of agreement being greater than the other) than if the median value were presented because the median (as can be seen in the results) can often be the same for both groups, irrespective of the Mann-Whitney U test results being statistically significant.

Brokers were found to be significantly more in agreement than bankers in response to the statements: Q1. *The increase in shares that are freely available to the investing public is positively related to good corporate performance* ($Z=-13.66, p<.0001$), Q2. *Separating the positions of chairperson and CEO has a positive effect on performance* ($Z=-9.76, p<.0001$), Q8. *A high percentage of independent non-executive directors in the nomination committee has a positive impact on corporate performance* ($Z=-9.76, p<.0001$), Q9. *The existence of many shareholders with an exceptionally large amount or value of stock sustains a good corporate governance system* ($Z=-5.96, p<.0001$), and Q13. *An audit committee should contain a high ratio of non-executive directors* ($Z=-6.82, p<.0001$).

In contrast, bankers were found to be significantly more in agreement than brokers in response to the statements: Q5. *The increase in nomination committee affects corporate performance in a positive way* ($Z=10.93, p<.0001$), Q6. *Frequent meetings of the nomination committee have a positive effect on corporate performance* ($Z=11.56, p<.0001$), Q7. *A large audit committee can facilitate effective monitoring* ($Z=7.75, p<.0001$), Q10. *Large sized boards are impediments to good performance* ($Z=12.24, p<.0001$), Q11. *Increasing the number of non-executive directors is helpful to a firm's management* ($Z=10.96, p<.0001$), and Q12. *Frequent board meetings allow good monitoring and smooth management of a firm* ($Z=11.38, p<.0001$).

Table 6.5: Corporate Governance and Corporate Performance – Results of the Wilcoxon-Mann-Whitney Test

Corporate Performance Questions: Mann-Whitney U-Tests (Banker $n=147$, Broker $n=156$)

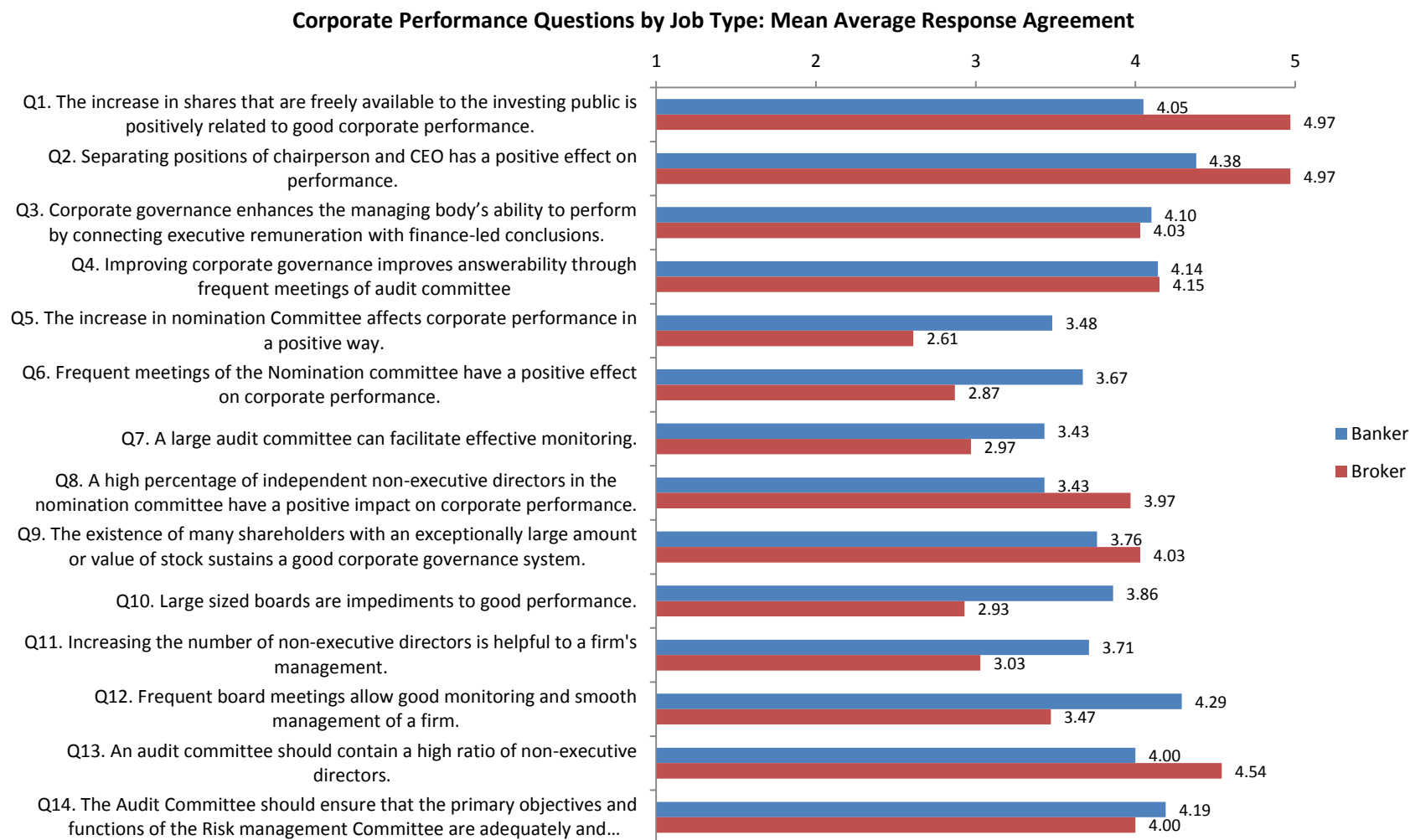
Question	Job Type	Mean	Median	Std Dev	Z-Value	Wilcoxon Probability
Q1. The increase in shares that are freely available to the investing public is positively related to good corporate performance.	Banker	4.05	4	0.58	-13.66***	<.0001
	Broker	4.97	5	0.16		
Q2. Separating positions of chairperson and CEO has a positive effect on performance.	Banker	4.38	4	0.72	-9.76***	<.0001
	Broker	4.97	5	0.16		
Q3. Corporate governance enhances the managing body's ability to perform by connecting executive remuneration with finance-led conclusions.	Banker	4.10	4	0.53	1.57	0.1171
	Broker	4.03	4	0.28		
Q4. Improving corporate governance improves answerability through frequent meetings of audit committee	Banker	4.14	4	0.89	1.93	0.0546
	Broker	4.15	4	0.36		
Q5. The increase in nomination Committee affects corporate performance in a positive way.	Banker	3.48	4	0.59	10.93***	<.0001
	Broker	2.61	3	0.49		
Q6. Frequent meetings of the Nomination committee have a positive effect on corporate performance.	Banker	3.67	4	0.57	11.56***	<.0001
	Broker	2.87	3	0.41		

Q7. A large audit committee can facilitate effective monitoring.	Banker	3.43	4	0.96	7.75***	<.0001
	Broker	2.97	3	0.28		
Q8. A high percentage of independent non-executive directors in the nomination committee have a positive impact on corporate performance.	Banker	3.43	3	0.59	-9.76***	<.0001
	Broker	3.97	4	0.16		
Q9. The existence of many shareholders with an exceptionally large amount or value of stock sustains a good corporate governance system.	Banker	3.76	4	0.53	-5.96***	<.0001
	Broker	4.03	4	0.16		
Q10. Large sized boards are impediments to good performance.	Banker	3.86	4	0.64	12.24***	<.0001
	Broker	2.93	3	0.36		
Q11. Increasing the number of non-executive directors is helpful to a firm's management.	Banker	3.71	4	0.70	10.96***	<.0001
	Broker	3.03	3	0.18		
Q12. Frequent board meetings allow good monitoring and smooth management of a firm.	Banker	4.29	4	0.45	11.38***	<.0001
	Broker	3.47	3	0.50		
Q13. An audit committee should contain a high ratio of non-executive directors.	Banker	4.00	4	0.69	-6.82***	<.0001
	Broker	4.54	5	0.50		

1 Strongly Disagree; 2 Disagree; 3 Not Sure; 4 Agree; 5 Strongly Agree

*Significant at the $p \leq 0.05$ level, ** Significant at the $p \leq 0.01$ level, *** Significant at the $p \leq 0.001$ level.

Table 6.6: Corporate Performance Questions: Mann-Whitney U test comparisons of Bankers and Brokers



6.4.3 Corporate Governance and Corporate Risk

The second part of the questionnaire contained 15 statements on a Likert scale, focusing on how corporate risk influences corporate governance. Questions in this section covered capital and liquidity risk. As with the previous section regarding performance, the statistical analysis of the responses was undertaken using Mann-Whitney U tests, the results of which appear in Table 6.6.

Brokers were found to be significantly more in agreement than bankers in responses to the statements: Q18. *The type of the shareholder affects consequences of corporate capital risk* ($Z=-12.66$, $p<.0001$), Q20. *Systematic liquidity risk increases with institutional ownership* ($Z=-5.34$, $p<.0001$) and Q27. *The degree of ownership concentration has a considerable impact on the behaviour of the risk management committee* ($Z=-9.85$, $p<.0001$).

In contrast, six statements indicated significantly higher levels of agreement for bankers compared to brokers. These were: Q14. *The audit committee should ensure that the primary objectives and functions of the risk management committee are adequately and effectively achieved* ($Z=6.61$, $p<.0001$), Q15. *Government-owned companies don't rely on managing risk that much since the Government almost never defaults* ($Z=7.05$, $p<.0001$), Q17. *A good corporate governance system ensures that the BODs have sufficient information to make sound decisions on important matters such as statutory changes, disposing of assets, and so on* ($Z=5.60$, $p<.0001$), Q21. *Consideration of the most relevant company structure in managing risk-related errors at the board-level* ($Z=7.86$, $p<.0001$), Q23. *The AC can understand the company's capital structure along with subsequent risks* ($Z=6.47$, $p<.0001$), and Q28. *The board's commitment to risk oversight should be communicated effectively throughout the organization* ($Z=15.87$, $p<.0001$).

Table 6.7: Corporate Governance and Corporate Risk

Corporate Risk Questions: Mann-Whitney U-Tests (Banker $n=147$, Broker $n=156$)

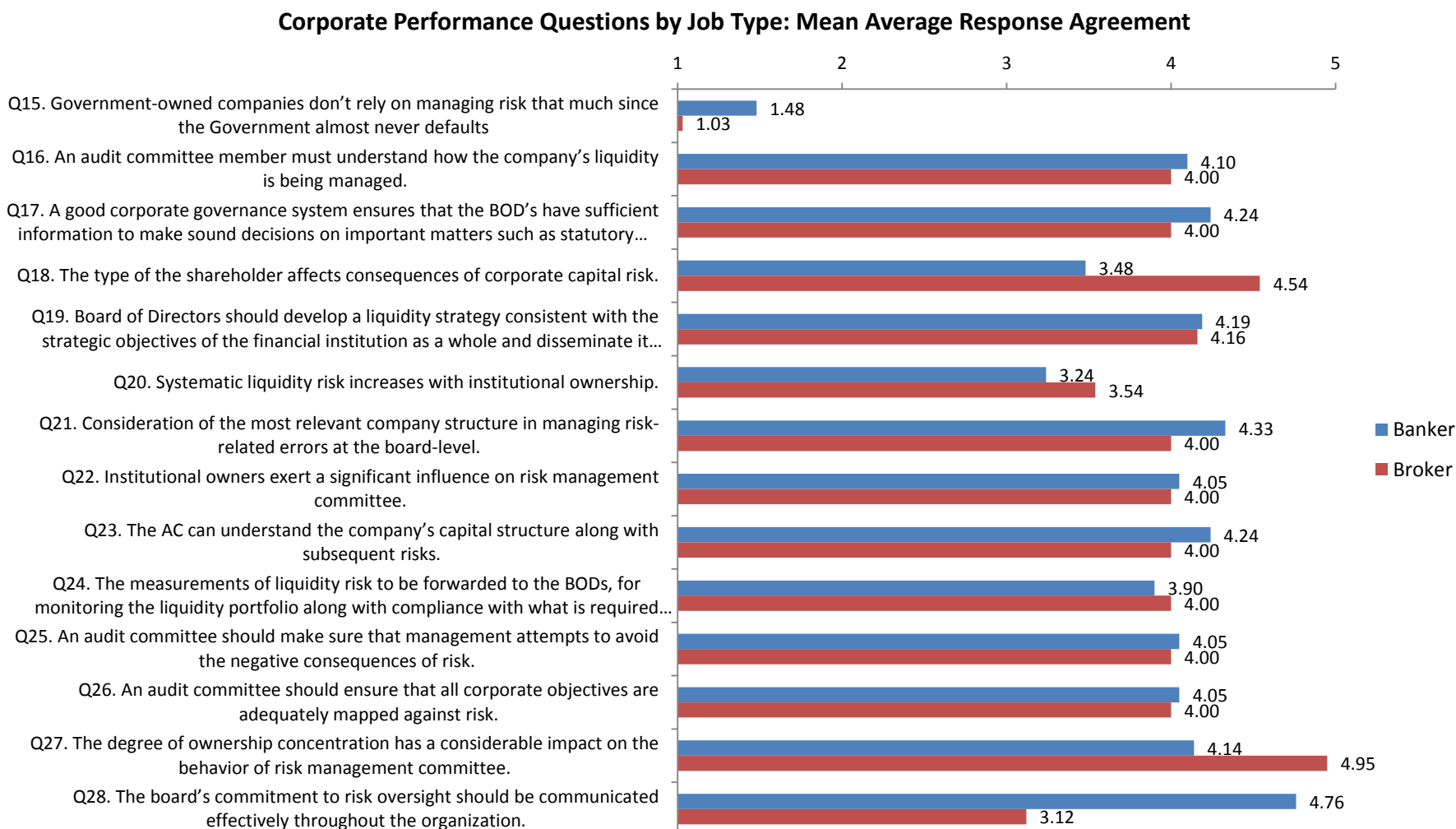
Question	Job Type	Mean	Median	Std Dev	Z-Value	Wilcoxon Probability
Q14. The Audit Committee should ensure that the primary objectives and functions of the Risk management Committee are adequately and effectively achieved.	Banker	4.19	4	1.01	6.61***	<.0001
	Broker	4.00	4	0.00		
Q15. Government-owned companies don't rely on managing risk that much since the Government almost never defaults	Banker	1.48	1	0.91	7.05***	<.0001
	Broker	1.03	1	0.16		
Q16. An audit committee member must understand how the company's liquidity is being managed.	Banker	4.10	4	0.75	1.82	0.0692
	Broker	4.00	4	0.00		
Q17. A good corporate governance system ensures that the BOD's have sufficient information to make sound decisions on important matters such as statutory changes, disposing of asset, and so on.	Banker	4.24	4	0.53	5.60***	<.0001
	Broker	4.00	4	0.00		
Q18. The type of the shareholder affects consequences of corporate capital risk.	Banker	3.48	3	0.50	-12.66***	<.0001
	Broker	4.54	5	0.50		
Q19. Board of Directors should develop a liquidity strategy consistent with the strategic objectives of the financial institution as a whole and disseminate it throughout the institution.	Banker	4.19	4	0.39	0.69	0.4908
	Broker	4.16	4	0.37		
Q20. Systematic liquidity risk increases with institutional ownership.	Banker	3.24	3	0.43	-5.34***	<.0001
	Broker	3.54	4	0.50		

Q21. Consideration of the most relevant company structure in managing risk-related errors at the board-level.	Banker	4.33	4	0.47	7.86***	<.0001
	Broker	4.00	4	0.00		
Q22. Institutional owners exert a significant influence on risk management committee.	Banker	4.05	4	0.49	1.29	0.1979
	Broker	4.00	4	0.00		
Q23. The AC can understand the company's capital structure along with subsequent risks.	Banker	4.24	4	0.43	6.47***	<.0001
	Broker	4.00	4	0.00		
Q24. The measurements of liquidity risk to be forwarded to the BODs, for monitoring the liquidity portfolio along with compliance with what is required by the government along with the yearly business	Banker	3.90	4	0.69	-1.12	0.2647
	Broker	4.00	4	0.00		
Q25. An audit committee should make sure that management attempts to avoid the negative consequences of risk.	Banker	4.05	4	0.58	1.12	0.2645
	Broker	4.00	4	0.00		
Q26. An audit committee should ensure that all corporate objectives are adequately mapped against risk.	Banker	4.05	4	0.66	1.01	0.3126
	Broker	4.00	4	0.00		
Q27. The degree of ownership concentration has a considerable impact on the behavior of risk management committee.	Banker	4.14	4	0.99	-9.85***	<.0001
	Broker	4.95	5	0.22		
Q28. The board's commitment to risk oversight should be communicated effectively throughout the organization.	Banker	4.76	5	0.43	15.87***	<.0001
	Broker	3.12	3	0.32		

1 Strongly Disagree; 2 Disagree; 3 Not Sure; 4 Agree 5 Strongly Agree

*Significant at the $p \leq 0.05$ level, ** Significant at the $p \leq 0.01$ level, *** Significant at the $p \leq 0.001$ level.

Table 6.8: Corporate Risk Questions: Mann-Whitney U test comparisons of Bankers and Brokers



6.5 Discussion

6.5.1 Corporate Performance

In the analysis of the statement in Q1. *The increase in shares that are freely available to the investing public is positively related to good corporate performance*, revealed significantly more agreement from brokers than bankers. Moreover, the mean average for brokers was close to total agreement (mean=4.97), suggesting that company performance depends upon the availability of opportunities for investors freely to transfer shares.

The results for the statement in Q2. *Separating positions of chairperson and CEO has a positive effect on performance* show brokers being more in agreement than bankers.

The third statement to the effect that *corporate governance enhances the managing body's ability to perform by connecting executive remuneration with finance-led conclusions*, revealed that both groups (bankers and brokers) responded similarly (Banker mean=4.10, Broker mean=4.03), therefore demonstrating no statistically significant difference between them.

In response to statement 4. *Improving corporate governance improves answerability through frequent meetings of audit committee* no significant differences were detected between bankers and brokers. However, both bankers and brokers were broadly supportive of having frequent meeting of the AC to support corporate governance (Banker mean=4.14, Broker mean=4.15).

A significant result was found for Q5. *The increase in nomination Committee affects corporate performance in a positive way*. Here, bankers indicated a significantly higher level of agreement than brokers, although agreement with this statement was low by both groups (Banker mean=3.48, Broker mean=2.61).

Similarly, bankers were also significantly more likely to agree with the statement Q6. *Frequent meetings of the Nomination committee have a positive effect on corporate performance* (Banker mean=3.67, Broker mean=2.87). This reflects the bankers' keenness to ensure that companies perform well financially so that bank funds are well protected as the loans are serviced properly by the companies in question. It is also possible that bankers also believe nomination committee meetings to facilitate the smooth functioning of the companies. Dahya et al. (2006) claimed that the role of the nomination committee is to enhance shareholders' value and, at the same time, to ensure that a viable financial position is established by the business. This committee is also in charge of identifying and nominating individuals for any executive and non-executive vacancies, and for forwarding

these names to the board for approval. Based on its views, corporate performance can be enhanced, since the committee conducts assessments and makes appropriate recommendations aimed at ensuring the effectiveness and continuity of the board, and the entire management group.

Brokers, in comparison, might be less concerned with the composition and functioning of the nomination committee because the use of this committee is not regulated by legislation. In the opinion of the bankers, nomination committees provide better control over companies' financial performance.

Bankers were also found to be more in agreement with the statement produced as Q7. *A large audit committee can facilitate effective monitoring* (Banker mean=3.43, Broker mean=2.97). This result may support agency theory as the board committees, responsible for answering to shareholder groups, are responsible for overseeing the board activities and guiding the directors in their decision-making. Thus, the main job of the audit, remuneration, and nomination committees can be considered as supervisory, intended to reduce agent-related issues (Klein, 1998; Rezaee, 2009). Through this function, the board committees are expected to increase the valuation of the firm for the shareholder groups by contributing to higher profitability and increasing the growth.

The major functions of an audit committee are to oversee the process related to the financial risks of the company, the internal controls, and the financial reporting, and these functions bring the key benefit that risk is more effectively controlled. Indeed, the audit committee determines the extent of the liberty offered to the managing body by the administration (Rezaee, 2009). Due to their financial exposure, bankers are more inclined to want efficient financial risk management, and hence, it is likely that the larger the size of the audit committee, the greater the chance of better risk management.

The impact of independent NEDs on the nomination committee on corporate performance was the focus of the eighth statement - Q8. *A high percentage of independent non-executive directors on the nomination committee has a positive impact on corporate performance*. In response to this statement, brokers were significantly more likely to believe there was a positive performance impact deriving from having a large percentage of independent NEDs on the board (Banker mean=3.43, Broker mean=3.97).

Earlier studies by Dehaene et al. (2001) report that where there is a majority of NEDs on the committee, firms reported higher ROE. This may result from the remuneration structure of NEDs, which relies more on the firm's ability to perform than does the remuneration package provided to executive directors. Furthermore, board effectiveness is greatly dependent upon board independence. The nomination committee should have the ability to

make use of the resources available in the company, and hence, it is important that the committee possesses the expertise required to discharge this function.

The ninth statement - Q9. *The existence of many shareholders with an exceptionally large amount or value of stock sustains a good corporate governance system*, drew significantly more agreement from brokers than bankers, perhaps due to their greater inclination towards a shareholder perspective (Banker mean=3.76, Broker mean=4.03).

Bankers were significantly more likely to state that they considered large boards as an impediment to good performance (Q10) (Banker mean=3.86, Broker mean=2.93). In this context, the findings from the study of Abdullah (2004), stressing the optimal board size and its correlation with organizational performance, need to be considered.

Higgs (2003) argued that the board size should be appropriate, and Singh and Davidson (2003) confirmed this finding that board size had a negative relationship with corporate performance when it was too big. Similarly, Eisenberg et al. (1998:35) found “a significant negative correlation between board size and profitability in a sample of small and mid-size firms”. And Lipton and Lorsch (1992) also found that having bigger boards can hinder the smooth progress of communication, co-ordination, and decision-making. These findings seem to align more with the bankers’ view than that of the brokers.

Statement 11 concerned whether having more NEDs on the board was helpful to a company’s management, and the findings were that bankers were significantly more likely to agree that more NEDs was indeed good for the management of the firm (Banker mean=3.71, Broker mean=3.03).

However, there is evidence that the number of NEDs does not provide any significant support to the management of a firm. The theories of agency and stewardship are relevant to the structure of the board. Separating the owning party from the managing body is part and parcel of the agent-specific ideology in present-day companies. Whilst stewardship theory considers the management members as the overseers of the company. This theory posits a need for a combination of ownership mechanisms, and boards comprising internal members as a means to increase the wealth of shareholder groups. In support of the stewardship theory, Dalton and Kesner (1987) found a direct correlation between the percentage of executive directors and a firm’s performance. However, other studies found no such relationship (Abdullah, 2004).

Due to the conflicting findings of previous studies regarding stewardship theory and the proportion of NEDs, it is advisable for firms to consider the nature and size of the

organization, and this should underpin the decision regarding the optimal proportion of NEDs on the board.

Bankers were significantly more likely than brokers to agree that board meetings, as shown in their responses to Q12. *Frequent board meetings allow good monitoring and smooth management of a firm* (Banker mean=4.29, Broker mean=3.47).

Q13 concerned whether the AC should contain a high ratios of NEDs. In response to this statement, brokers were significantly more likely to agree than bankers, believing the AC would be more effective in contributing towards improved corporate performance with such representation (Banker mean=4.00, Broker mean=4.54). However, both groups were in agreement with the statement. From a risk control perspective, brokers may believe that having a higher percentage of NEDs has a significant bearing on understanding and controlling risk, and controls the freedom given to the managing body by the administration.

Literature supporting the influence of the AC on the effectiveness of the risk management in firms is limited. However, one study that did look at this issue found that companies that adopted ACs performed in a much better capacity as opposed to others that did not (Laing and Weir, 1999).

Despite the limited research in this area, it may still be possible to hypothesize that as ACs are able to supervise the activities of the company, their presence may lead to a positive influence upon risk management, which would in turn, result in companies managing their risks more effectively. It is also possible that a properly constituted audit committee with more NEDs could produce greater insights into the organization's accounting and control system.

In respect of the results obtained, it should be noted that whilst bankers provided less support than brokers for a high ratio of NEDs on the AC, they were nonetheless, very supportive in general (mean=4.00), thus implying that the suggestion is broadly encouraged in both sections of the industry.

6.5.2 Corporate Risk

The items on corporate risk began at Q14 with the statement *The Audit Committee should ensure that the primary objectives and functions of the Risk management Committee are adequately and effectively achieved*. In their responses to this statement, bankers were significantly more supportive of the AC's function in this respect than brokers (Banker mean=4.19, Broker mean=4.00).

The board is required to ensure “that within them, a minimum of one member has recent, relevant financial experience and preferably a professional accounting qualification” (Yang and Krishnan, 2005). Clearly, not all board members can be expected to possess expert knowledge about preparing and presenting proper financial statements. Therefore, the audit committee members have an important role to play in providing more insight into the organization’s accounting and control systems, which in turn, facilitates better risk management and financial control.

Effective risk management, as part of corporate governance, should also aid government organizations in improving the quality of their service they deliver to citizens, which is crucial since the extent of openness about their performance affects people’s trust in them. Since it is both the financial guarantee provided by the government for the performance of government organizations, and the quality of the service delivery that builds public trust, it is imperative that government organizations also engage in risk management.

However, quite strong disagreement emerged with the statement *Q15. Government-owned companies don’t rely on managing risk that much since the Government almost never defaults* in respect of both bankers (mean=1.48) and brokers (mean=1.03). Whilst brokers were significantly more likely to disagree than bankers, the fact remains that both populations believed that government-owned companies did require a risk management committee. This may reflect stakeholder groups’ reliance on government-induced guarantees to manage risk efficiently in these organizations (Vafeas, 2000).

No significant differences were found between bankers and brokers in respect of the statement appearing as *Q16. An audit committee member must understand how the company’s liquidity is being managed*. Here, both groups of respondent strongly agreed on the necessity for audit committee members’ understanding of the mechanisms used by the company to manage its liquidity (Banker mean = 4.10, Broker mean = 4.00).

Duncan (1991) stated that the AC should assess the prime risks facing the company, and examine its counter-measures to control these. In other words, to evaluate the fall-back situation, and other security mechanisms, and the different tools available to deal with such risks. It is also the duty of the AC to recommend improvements to the company’s activities by identifying and controlling important financial risks.

Q17 concerned whether respondents agreed that a good corporate governance system ensures that the board of directors is *sufficiently informed of the decisions about fundamental issues, such as statutory changes or the disposal of assets*. Both bankers and brokers showed support for this this viewpoint (Banker mean=4.24, Broker mean=4.00).

However, statistical testing indicated the opinion to be significantly stronger among bankers than brokers.

Cowan (2004) stated that, “the complexity of today’s business environment necessitates the committee understanding the importance of risk management” In Q18, views on the influence of the type of shareholders on corporate risks were probed, it being revealed that brokers were significantly more likely to believe that shareholder type would influence corporate risk (Banker mean=3.48, Broker mean=4.54).

Q19 explored asked whether the *Board of Directors should develop a liquidity strategy consistent with the strategic objectives of the financial institution as a whole and disseminate it throughout the institution.* This view attracted the strong support of both the bankers and brokers (Banker mean=4.19, Broker mean=4.16), with no significant differences being found between their views.

The statement in Q20 concerned whether systematic liquidity risk increases with institutional ownership. Brokers were significantly more likely to agree that liquidity did increase under these circumstances (Banker mean=3.24, Broker mean=3.54).

The impact of company structure on risk management was addressed in Q21, which asked for *Consideration of the most relevant company structure in managing risk-related errors at the board-level.* Both groups agreed with this statement, but bankers were significantly more likely to agree (Banker mean=4.33, Broker mean=4.00).

No significant differences were found between bankers and brokers in their responses to the statement contained in Q22. *Institutional owners exert a significant influence on the risk management committee.* In this connection, both bankers (mean=4.05) and brokers (mean=4.00) were in agreement that institutional owners have an influence on the risk management committee.

Q23 asked whether *The AC can understand the company’s capital structure along with subsequent risks.* There was a consensus between the bankers (mean=4.24) and brokers (mean=4.00) that this was the case, although bankers were significantly more likely to agree with this statement than brokers.

Q24 asked the respondents about their views on *The measurements of liquidity risk to be forwarded to the BODs, for monitoring the liquidity portfolio along with compliance with what’s required by the government along with the yearly business plan.* Bankers (mean=3.90) and brokers (mean=4.00) both agreed with the statement with no significant differences found between their responses.

Whether the audit committee should ensure that the management attempts to avoid the negative consequences of risk was the focus of Q25. Mean averages of agreement for the two groups indicated that both agreed with this statement (Banker mean=4.05, Broker mean=4.00). However, no significant differences were detected between bankers and brokers in their average responses.

Q26 asked whether *An audit committee should ensure that all corporate objectives are adequately mapped against risk*. Both groups agreed that objectives should be mapped against risk (Banker mean=4.05, Broker mean=4.00). However, as with Q25, no significant differences were detected between the groups.

Brokers were significantly more likely to agree with Q27. *The degree of ownership concentration has a considerable impact on the behaviour of the risk management committee*. In response to this statement, brokers showed a mean average response close to full agreement (mean=4.95), while bankers also agreed but less strongly (mean=4.14).

In response to Q28, bankers were significantly more likely to state that *The board's commitment to risk oversight should be communicated effectively throughout the organization* than brokers were. In response to this statement, brokers indicated almost full agreement on average (mean=4.76), while the mean for bankers was considerably lower (mean=3.12).

6.6 Comparing the Questionnaire and Empirical Investigation Results

6.6.1 Corporate Performance

Empirical investigation in terms of correlation suggests that the board size has strong correlation with the audit committee size. Empirical investigation suggests that in terms of the ROE and ROA models, BS and corporate performance do not have any significant negative relationship. The results of the empirical investigation suggests that the impact of BS on corporate performance is slightly positive, which suggests that the larger BS contributes to better corporate performance. The results of the survey suggest that the bankers supported larger board size. This result is opposite with that of the empirical investigation. The majority of the bankers agreed that with the statement that "large boards as an impediment to good performance" (Banker mean=3.86, Broker mean=2.93).

The study used role duality as an independent variable, which affects corporate performance. For ROE and ROA models, the relationship between role duality and performance was found to be positive. Hence, empirical investigation suggests that role

duality and corporate performance have a positive relationship. The results of the questionnaire is not similar to that of empirical investigation. In terms of corporate performance and role duality, questionnaires revealed that the brokers agreed that separation of the positions of chairperson and CEO has positive impact on performance as compared to bankers. Consequently, brokers believed that separation of positions of chairperson and CEO have positive impact on performance.

Empirical investigation and analysis suggests that for ROA and ROE models, the relationship between the number of non-executive directors and corporate performance is not positively significant.

Both ROA and ROE models suggest that the relationship between audit committee size and corporate performance is not positively significant. In terms of the questionnaires, bankers agreed “ *A large audit committee can facilitate effective monitoring*” (Banker mean=3.43, Broker mean=2.97). The results of the empirical investigation and the questionnaire are contrasting. Bankers agreed that large audit committee helped in improving corporate performance through monitoring mechanisms.

In ROE and ROA models, audit committee size impact on the audit committee and corporate performance is not positively significant. In terms of audit committee and the percentage of NEDs, the brokers were more likely to agree that it improved corporate performance. It should be noted that bankers also supported the large proportion of NEDs in Audit committee. Empirical and questionnaire results are contrasting.

Empirical investigation suggests that for both ROA and ROE models, the relationship between remuneration committee and corporate performance is neither significant nor negative. Questionnaires results show that both bankers and brokers agree with the statement “*corporate governance enhances the managing body’s ability to perform by connecting executive remuneration with finance-led conclusions*”. The questionnaire’s results show that remuneration committee helps in improving corporate performance.

6.6.2 Corporate Risk

In order to measure risk, two models were used: Liquidity Risk model and Capital Risk model. In terms of Board size, it was found out that the impact of the board size on both risk models were found to be insignificant. Questionnaires do not specify the size of the board to discuss the impact of board size on the corporate risk. However, the questionnaires do suggest that the board is important for good corporate governance system since the bankers and brokers agree with the statement that “ a good corporate governance system ensures that the board of directors is sufficiently informed of the decisions about

fundamental issues, such as statutory changes or the disposal of assets”. Bankers agreed to the statement slightly higher than the brokers. In terms of role duality, both models showed that the role duality did not have a significant relationship with the corporate risk. The questionnaires did not measure the role duality. It does suggest that the “The degree of ownership concentration has a considerable impact on the behaviour of the risk management committee” since the majority of the brokers agree to this statement.

Empirical investigations suggested that the number of non-executive directors and corporate risk was found to be negative. In liquidity and capital risk models, the relationship was present but was not found to be albeit. Questionnaires suggest that the use of non-executive directors is needed since institutional ownership can increase corporate risk.

Empirical investigation suggests that the relationship between the audit committee size and corporate risk model was found to be significant. Greater size of the audit committee lead to greater risk. The proportion of NEDs in AC in both risk models was found to be negative. The number of NEDs increase in AC, the risk decreased. The results suggest that the NEDS increased and the risk decreased. Empirical investigation shows that for both liquidity and capital risk models show that the presence of remuneration committee increased the exposure of risk. However, this relationship has been verified tentatively and not conclusively. In order to measure risk, two models were used: Liquidity Risk model and Capital Risk model.

Empirical investigations suggested that the number of non-executive directors and corporate risk was found to be negative. In liquidity and capital risk models, the relationship was present but was not found to be albeit. The liquidity risk increases with respect to institutional ownership as indicated by the questionnaire. The majority of the brokers agreed to the statement. This suggests that institutional ownership can have a significant impact on the corporate risk mechanism and therefore, it is necessary to have non-executive directors on the board. This is further verified that bankers and brokers agreed to the statement that “ Institutional owners exert a significant influence on the risk management committee”.

Empirical investigation suggests that the relationship between the audit committee size and corporate risk model was found to be significant. Greater size of the audit committee lead to greater risk. The results of the questionnaires suggests that there is strongly need for Audit committee to avert corporate risk. The proportion of NEDs in AC in both risk models was found to be negative. The number of NEDs increase in AC, the risk decreased. The results suggest that the NEDS increased and the risk decreased. Although the questionnaire do not strictly emphasize on the number of NEDs in AC, the results show that Audit Committee is needed to improve risk management mechanisms.

6.7 Conclusion

The analysis of the responses to the questions leads to several conclusions. Overall, the findings from the survey suggest that the performance of the company does depend upon the board of directors, as well as on the effectiveness of its members. This observation echoes that of Higgs (2003) who found the effectiveness of the board to affect corporate performance either negatively or positively, depending upon a range of variables. Indeed, in this study, a significant relationship was seen to exist between the board and corporate performance, as both bankers and brokers were in sound agreement on this issue. However, it is important to note that good corporate performance is not a guaranteed outcome of board influence, and that from a resource dependency viewpoint, it is necessary for the board to be able to accumulate resources from various external sources, and put them to maximum use. This requires effective deliberation among the board members, who must be able to arrive at optimal corporate decisions. The optimality of the business decisions often depends upon the size of the board, which must not be too big as to be unwieldy, or too small as to be lacking in expertise. Board size has always been a controversial topic in corporate governance studies. This study concludes that the optimum board size for any organization is a reflection of various factors, such as the age of a company, size of its operations, nature of the business, extent of supervision, plus the value-addition deemed necessary, among other variables.

There is also an association between the frequency with which the board meets and corporate performance, since more frequent board meetings may considerably improve this. Indeed, Adams and Ferreira (2007) were of the view that the value of a company rose with the increase in the number of board meetings.

This issue of frequency ties in with the variable identified by Lipton and Lorsch (1992), who found a lack of time on the part of directors to be a problem, preventing them from meeting the expectations of the organization. Thus, it is essential to allocate sufficient time to board meetings if directors are to be useful to the board. When directors do not meet often, there is a chance that the corporate risk, which is present in all firms, might increase. It is incumbent upon the board to find strategies to deal with this.

In respect of role duality, the study finds that both bankers and brokers are aware of a significant direct relationship between this and board performance (hence corporate performance), echoing the findings of Mike et al. (2007). There are arguments for and against such arrangement. Clearly, the CEO directs and manages the corporate affairs, and in this s/he must ensure transparency in decision-making, and be accountable to the shareholders for the decisions made. Role duality plays an integral part in improving the finance-led performance with respect to the company context, and for a small firm, it may

be worth combining the role of CEO and chairperson. However, in the case of large firms, such combination may not only reduce the effectiveness of the board but also lead to corporate fraud, as has been evidenced in the past. Corporate risk is associated with many features that relate to both the internal and external environment of the firm and over which the board may never have full control, despite its nature or structure.

With regard to the composition of the board of directors, and its effect upon financial performance, external directors are thought to bring considerable knowledge to board deliberations because of their wide exposure and experience. Such knowledge is believed to improve the quality of the decisions made by the board. This is not to suggest that the company executives who are also on the board have nothing to contribute, since they may possess considerable technical knowledge. However, there is the need for an additional practical approach to business issues, which can be gained only through experience, and that experience can lead to an effective decision-making process. The literature tends to agree on the positive influence of a greater proportion of external directors on board effectiveness, generally because of the widespread recognition of agency theory, which assumes that the modern separation of ownership from control (management), brings the potential for management to pursue its own interests instead of those of the company. Additionally, the agency angle has its roots in control-based theory, which postulates that management members are in a position to gain advantage because of their firm-specific knowledge, whereas shareholders (as owners) are ignorant of the operational aspects of the firm. By gaining control over a firm's activities, management may deviate from the interests of the ownership and look to pursue its own. The potential for this eventuality calls for the implementation of control mechanisms that can protect the interests of the shareholders. An important expectation of the board of directors is the fulfilment of this supervisory task. Consequently, it is entirely logical that effective boards will be seen as those which are composed of a higher proportion of external directors to internal executives. These external directors are believed to both enhance the performance of the company, and contribute towards the protection of the shareholders' interests.

The findings also indicate an association between the presence of non-executive directors on firms' audit committees, and the overall corporate performance of those firms. This study observes that the promotion of audit committees is likely to improve the director, investor, and auditor relation, which are vital for ensuring accuracy and transparency in terms of reporting finance-specific information. Thus, the AC's are able to help the directors in the discharge of their duties. It can also be argued that audit committees might have an impact of increased answerability pertaining to the auditing process. Audit committees can also influence the audit function in practice by assisting the board with the appointment, removal, and fixation of remuneration of the auditors. In addition, the AC has enough power to decide the relevance and degree of relevant work, ensuring liberty to the auditor to make important

decisions and judgment along with bridging any ill feelings that could develop between the auditing and managing bodies. It is also necessary to consider the effects of audit committees with respect to the internals of auditing functionality, along with relevant checks and balances further accented by having a firm say in the company's risk management policy. Audit committees have a duty to comment upon the accounting policies of companies and may have to approve the choice of accounting policies. This study observes that this is an important duty for audit committees from the perspective of improving the transparency of the financial statements. This study considers that the AC's still have a long way to go in terms of monitoring the reliability of the company's accounting processes, and they may have to ensure that they are fully implemented in light of the legal as well as ethical specifications. Finally, the question arises pertaining to the advantage given to ACs in relation to corporate governance frameworks in helping to improve the company's ability to perform better, which is the theme of this study. Although it may be difficult to come up with a direct relation to the role of an AC significantly improving the company's performance, the recommendations pertaining to management and government structures may be used as a facilitator in terms of controlling and managing the firm well, which may result in positive improvements in corporate performance.

Audit committee meetings are important for the AC; however, the AC is only able to report about the financial issues and position of the firm to the board. It was noted that a high meeting frequency would trigger an increase in the financial performance of the company. This was empirical to the agency theory, which states that, whenever the board and audit committees meet frequently, they develop an avenue for effectively advising on the disciplining and monitoring of the management activities of an organization.

The statistical tests conducted indicate that the bankers and brokers did not consider an association of any significance to exist between the percentage of NEDs on the audit committees and the corporate risk of the company. However, it is reasonable to believe that, when the proportion of NEDs on the audit committee goes up, the risk levels of the company are likely to go down. The professional qualifications of the NED members bring with them the required human capital. The NED members also have the opportunity to learn about the organizational environment, examining the accounting and financial management aspects of the organization through risks audits. This association results in an increase in the proportion of NEDs on the audit committees, leading to a reduction in risk.

The study has observed a significant association between the nomination committees and corporate performance. These committees have been found positively to affect the corporate performance of firms. The job entailing the nomination committee is to enhance the shareholders' value while at the same time ensuring that a viable financial position is established in the business. The nomination committee is also in charge of identifying and

nominating executive and non-executive vacancies. The nature and quality of the management staff appointed by the nomination committee determines the corporate risk levels of the company. A number of academics argue that corporate performance largely depends on the quality of employees that an organization can put together, which is the reason why a nominations committee is formed in the first place. A company can achieve the best corporate performance when the nominations committee brings in high quality, experienced top managers. On the other hand, the study concludes that there exists a direct relation entailing the existence of a remunerations committee with respect to the corporate performance of a company, but no relation entailing the existence of a remunerations committee with respect to the corporate risk of a company. Corporate risk, as has been elaborated before, depends on many conditions within the environment of the firm. It is concluded that the remunerations committee cannot influence the risk management pertaining to the firm significantly. Moreover, the remuneration committee carries out function of determining the right compensation for the workers as well as negotiating the contracts and compensation for the management level staff to ensure their satisfaction, since the executive performance can also be pegged on remuneration when negotiating contracts and the fixing of proper rewards is most likely to enhance the executive performance as well as the overall organizational performance.

Ownership structure is an important element in affecting the company's ability to perform. This study finds the existence of a significant relationship entailing free floats and corporate performance. Furthermore, the separation of ownership and control into free floats can play a vital part in the performance of a firm, as was shown by Demsetz and Villalonga (2001), who found the size of the float to be important. In this respect they noted that as free floats are not considered the optimal corporate ownership structure for firms, sometimes sub-optimal corporate performance is attributed to them (see also Demsetz and Lehn, 1985; Fama and Jensen, 1983; Lehmann and Weigand, 2000). On the other hand, freehold banks have been observed to exercise less risk-taking behaviour than those controlled by an owner (Saunders et al., 1990). Thus, freehold is associated with varying degrees of risk, and this has been widely accepted by several financial experts and academics (Lehmann and Weigand, 2000; Demsetz and Villalonga, 2001).

The study concludes that there exists an important connection between block-holder ownership and corporate performance, but that there is no such relationship between block-holder ownership and corporate risk. Although several factors related to the running of a firm, including corporate risk, asset liquidity and profitability, affect the decision-making of institutional investors, there is no significant evidence to point to the fact that block-holder ownership is associated with corporate risk, as has previously been highlighted. If anything, corporate risk is considered the norm by many financial experts in modern business, and it

plays an almost insignificant role in the block-holder ownership decisions (Black et al., 2006; Gompers et al., 2003).

Having presented the analysis of the empirical findings generated by the survey, the thesis moves in the next chapter to offer the concluding remarks.

Chapter 7: Conclusion

7.1 Introduction

The financial crisis that began in 2007 led to the closure of many large institutions and corporations including banks and other financial institutions all over the world. It is suggested that the major cause of the financial crisis may be the failure of the boards of these large institutions to understand and react to the emerging risks (Bernanke, 2010). Not surprisingly, the financial crisis severely affected the stability and profitability of the banking sector, posing threats to the global economy (Bernanke, 2010). Consequently, the changed scenario after the financial crisis reiterated the need for stricter corporate governance initiatives in banks to ensure the sustenance and growth of the entire sector (Erkens et al., 2012). Despite the fact that the issue of corporate governance received greater attention after large corporate financial frauds like Enron, the large banks failed to implement corporate governance practices in their respective organisations, which led to serious financial repercussions. In this context, the present study sought to understand the impact of corporate governance with respect to the overall performance of the banking sector and risk management by the banks. Among several risk areas, it focused on the capital risk and liquidity risk of banks as the main variables.

From a theoretical perspective, the study adopted the agency-stakeholder theory, which was considered an important element of the positive accounting theory, requiring descriptive research. It was also necessary to determine whether a quantitative or qualitative approach was more appropriate. In the event, it was decided that the objective ontological position assumed by the study required a quantitative design to enable the testing of the hypotheses developed after considering the stakeholder-agency and stewardship theories employed by the study. Having comprehensively considered several aspects of the research methodology, an objectivist ontology and positivist epistemological position was adopted. Hence, the study embodies neo-empirical research adopting a positive accounting theory (descriptive research) represented by the stakeholder/agency theory. Additionally, a hypothetic-deductive methodological approach was taken because of its suitability for testing theory through research hypotheses. Consequently, the study employed a quantitative design to examine the set of hypotheses developed as a response to the literature and theoretical positions chosen. In operational terms, the study was conducted via a survey which allowed for the collection of data based on two time horizons, longitudinal and cross-sectional, thereby providing a rich source of primary data. Simultaneously, secondary data was acquired from the literature, and from documentary evidence provided on the websites of the banks in the sample.

Objectivism was adopted as the ontological position for the study. Hence, it was decided that functionalist paradigm would be the most appropriate. The study was designed to include two research models, the first incorporating the collection of secondary data using a checklist of different items to form a secondary data index, and the second involving the distribution of a questionnaire to gather primary data from the sample identified. Both research models were classified according to the survey time horizons. The first model was considered a longitudinal survey for the selected sample, while the second was a cross-sectional survey of the selected groups of respondents. The questionnaire was self-administered, and designed to collect corporate governance data. The required financial data was secondary in nature, and acquired through the documentary search relating to the participating banks, and that was conducted through annual reports and general website information covering the five year period from 2006-2010. The study also used two econometric models – the performance model and the risk model – in order to empirically to analyse the data collected. Six hypotheses were formulated proposing the dimension and directions of various corporate governance variables in an attempt to test their association and impact on corporate performance and risk. These hypotheses were tested using the econometric models and based on the statistical analysis of the data collected from the survey.

The questionnaire constructed for the main survey explored the same themes as those in the econometric models, and presented questions that were focused on the corporate governance variables, like the characteristics of various boards, ownership structure, and board committees. This strategy established a close connection between the questionnaire survey and the econometric models. In fact, the questionnaire was divided into two parts, with questions on the role and influence of corporate governance on the bank's ability to perform, and risk management respectively. In building the econometric models and in drawing the questions for the questionnaire, much effort was made to ensure that they were bound by a common theme. This connection is evident from the findings of the survey and the empirical results of the econometric models to the extent that they complement each other.

7.2 Results and Findings

The findings of this research demonstrate that a significant relationship does exist between bank performance and corporate governance initiatives, and this observation suggests that the performance of a banking company depends upon Board Size or how effective its relevant members are. This suggestion supports Higgs' (2003) assertion that board effectiveness affects corporate performance, either negatively or positively. The results show that there is no significant negative link between Board Size and Corporate Performance in either the ROA or ROE models. Here, Board Size showed a small positive

effect on Corporate Performance in the parameter estimates, meaning that there was a small, but not significant tendency, for a larger board to indicate better corporate performance.

With regard to the constituents of the board (the proportion of NEDs), Corporate Performance and Capital Risk are associated with many aspects that relate to both the internal and external environments of the firm over which the board may never have full control despite its nature or structure (Mamoghli and Dhouibi, 2009). The results of this study are negative and non-significant with regard to the proportion of NEDs and Corporate Risk. The number of NEDs when considered in terms of Corporate Risk indicated negative parameters. This relationship, although not significant, found with respect to Liquidity Risk and Capital Risk, indicates that Hypothesis H4b is accepted, although not conclusively. The study finds a direct negative relationship between the presence of NEDs on the audit committees of banks, and the corporate risk of those banks. There was a significant relationship between the proportion of NEDs on an AC and Corporate Risk in both the Liquidity Risk and Capital Risk models. The negative parameter estimates in these models indicated that as the proportion of NEDs increased, the exposure to risk decreased. This is supported by prior studies that demonstrate the professional qualifications of the NEDs to be valuable in supplying the required human capital. The NEDs also have the opportunity to learn about the organisational environment, examining the accounting and financial management aspects of the institution through undertaking risks audits. Thus, this association results in an increase in the proportion of NEDs, leading to a reduction in risk. The context of this study relates to the banking companies operating in the UK, where the Combined Code of corporate governance has provided extensive guidelines on corporate governance practices. The important recommendation is with respect to the introduction of NEDs onto the board, and most of the banks appear to follow this principle. Therefore, the finding of this study does not differ from those of previous studies conducted in other countries.

Based on this finding, it is suggested that companies should adopt an optimum sized board with the required level of participation from NEDs. This will contribute to the increased effectiveness of the board performance. Large and small sized boards have their own merits and demerits. While a small board may contribute effectively to the decision-making process, a smaller number of directors cannot be said to have the required experience. At the same time, on a large board, because of the extended deliberations, decisions might be delayed and in some instances, conflicts between directors may lead to deadlock. It is, therefore, important that the company decide an optimum size for the board, and such decision may rest of the nature of the business, the calibre of the existing directors, and the potential issues that the company is likely to face. In the matter of role duality, as suggested in the previous literature, this might lead to power being concentrated in just one person,

which might be detrimental to the interests of the company as well as the shareholders. The appointment of committees and sub-committees may contribute to improved financial performance and risk management. Again, the results are quite subjective as the calibre and involvement of the committee members in company activities dictate the effectiveness and contribution of these committees.

The study finds a non-significant negative relationship between AC size and corporate performance, but there is a significant positive relationship between AC size and the corporate risk. There is no positive significant link identified between the size of the audit committee and performance.

Furthermore, The study finds a direct relationship between the existence of a remunerations committee and a bank's corporate risk. An increase in exposure to risk was observed between the existence of a remuneration committee and corporate risk in both the Liquidity Risk and Capital Risk models. The presence of a Remuneration Committee was almost significant in the Capital Risk model but not in the Liquidity Risk model despite being positive in both. Corporate risk, as already detailed, depends on many conditions within the environment of the firm and remunerations can affect it significantly as indicated in the following quote:

“The main role and function of the Remuneration Committee is to assist the Board in developing and administering a fair and transparent procedure for setting policy on the overall human resources strategy of the Group and the remuneration of Directors and senior management of the Group, and for determining their remuneration packages, on the basis of their merit, qualifications, and competence, and having regard to the Company's operating results, individual performance, and comparable market statistics” (Ttigroup.com, 2010, p. 1).

The remuneration committee can, at best, provide the broad policies regarding how the employees and directors need to be remunerated. Generally, the committees offer suggestions in this respect and it is up to the CEO and the concerned managers to decide whether to follow their recommendations or not. In many instances, the remuneration committees may simply endorse the views of the CEO or other executive directors who are in charge of the portfolio. Therefore, the remuneration committee may not have a serious impact on performance or risk reduction. This is the view expressed by the respondents.

7.3 Recommendations and Implications of the Study

In the light of the main aim of this research, which was to understand the influence of corporate governance on the performance and risk of UK banking institutes, for the period 2006-2010, the experimental study results suggest a number of recommendations, as follows:

1. There should be greater board independence and composition as both performance and risk reduction depend on these factors. The more controls that are imposed on banks' management, the lower the performance. Hence, there should be a balance between the controls enforced, and the amount of independence allowed of board members.
2. It is in banks' key interests to adopt good governing policies, which can further be ensured by establishing certain checks and balances.
3. If the purpose of board independence is to discipline the management of poorly performing firms or otherwise monitor it, then board independence has merit.

7.4 Limitations and Future Research

While the research findings are important, like any other empirical research, this study suffers from several limitations that need to be acknowledged since they may have impeded the progress of the study. The first limitation relates to the sample selection procedure and the size of the sample, which is relatively small and the five-year period seems short. However, some previous studies have used smaller samples, and others have used only one year cross-sectional samples (e.g., Klapper and Love, 2004; Black et al., 2006). Because of the practical limitations of time, effort, and finance associated with this study, the sample size had to be one that was statistically large enough to make a significant contribution, yet it also had to be manageable within the confines of the PhD.

The second limitation relates to the use of a questionnaire, as the data secured from such an instrument is considered by some scholars (see Shleifer and Vishny, 1997; McConnell, 1990; Durnev and Kim, 2002) to suffer from a degree of subjectivity and bias in construction. Specifically, this relates to potential definitional problems with some of the corporate governance variables used in the study. For example, the board size was not defined to exclude shadow or grey directors, and NEDs were not distinguished as independent or non-independent. However, this definitional issue does not appear to have much of an influence pertaining to the research results.

A third limitation is the possibility that the study might suffer from potential omitted variables bias. In the case of the financial performance variables, like ROA and ROE, they may fail to capture the informal personal interactions among different stakeholders that may potentially affect the financial performance of a firm. In the case of corporate governance variables, the variables may be unable to capture the true intentions with which the managers might be following the practices. For example, even though the managers might be aware that NEDs may be practically ineffective in monitoring their actions, they may still

appoint NEDs to merely signal their intention to treat outsiders or shareholders fairly. However, this study followed the examples of previous studies in adopting these research variables. Therefore, the research findings must be appreciated in the context of the limitations outlined above. Moreover, it should be accepted that these limitations potentially lead to further avenues of research.

In this respect, the path is opened up to several areas of discussion, for instance: the relationship between CEO turnover and bank performance, the relationship between good design of compensation packages on bank performance, the impact of role duality on bank performance and risk, and the relationship between the type of corporate governance imposed within banking institutes as a result of national influence, and bank performance and risk. Another topic of interest would be the impact of cross-border mergers and acquisitions of banks within a specific region on corporate governance, and the consequent impact on bank performance.

Future work might also incorporate a refined focus that seeks only to analyse statistics from the major banks, such as HSBC Holdings, Bank of America, and Barclays PLC. This would allow for a more in-depth investigation of common variables among these banks, and thus provide conclusive findings on the effect of corporate governance on risk and performance.

A longer sampling range would also be useful, preferably one extending to a period of at least ten years, to be able to observe how risk and performance have been affected before, during, and after the financial crises. This would provide information regarding post-recession relief.

Appendices

Appendix I: Questionnaire

Questionnaire

The usefulness of corporate governance in enhancing performance and reducing corporate risk banking sector

Dear Sir,

This questionnaire consists of (28) statements. Each of them is followed by (5) responses ranging from "strongly disagree" to "strongly agree". The questionnaire is part of a study aiming at recognizing the perceptions of different stakeholders towards the usefulness of corporate governance in enhancing performance and reducing corporate risk in banks. All the information will be used for research purpose only. Any data provided by the participants will be kept strictly confidential.

Please, read each statement fully, and then indicate your degree of agreement with each statement by ticking the corresponding box. Please tick only the one box that BEST represents true opinion about it. There is neither a right nor a wrong answer. Any response you provide is valid as it expresses your actual perception of the research topic.

Thanks for your cooperation.

The researcher

Part A – Personal Information

* Gender -----

- Male
- Female

* Age -----

- From 25 to 35
- From 36 to 45
- More than 45

* Education -----

- Bachelor degree
- Master's degree
- PHD degree or post-doctorate

* Industry Sector -----

- Banking
- Business institution

* Years of experience -----

- Below 5 years
- From 5 to 10 years
- From 10 to 20 years
- More than 20 years

Part B – Corporate Governance in Banks

1. How far does good corporate governance enhance the performance of an organization?

2. What is the extent of contribution made by good corporate governance to reduce corporate risk?

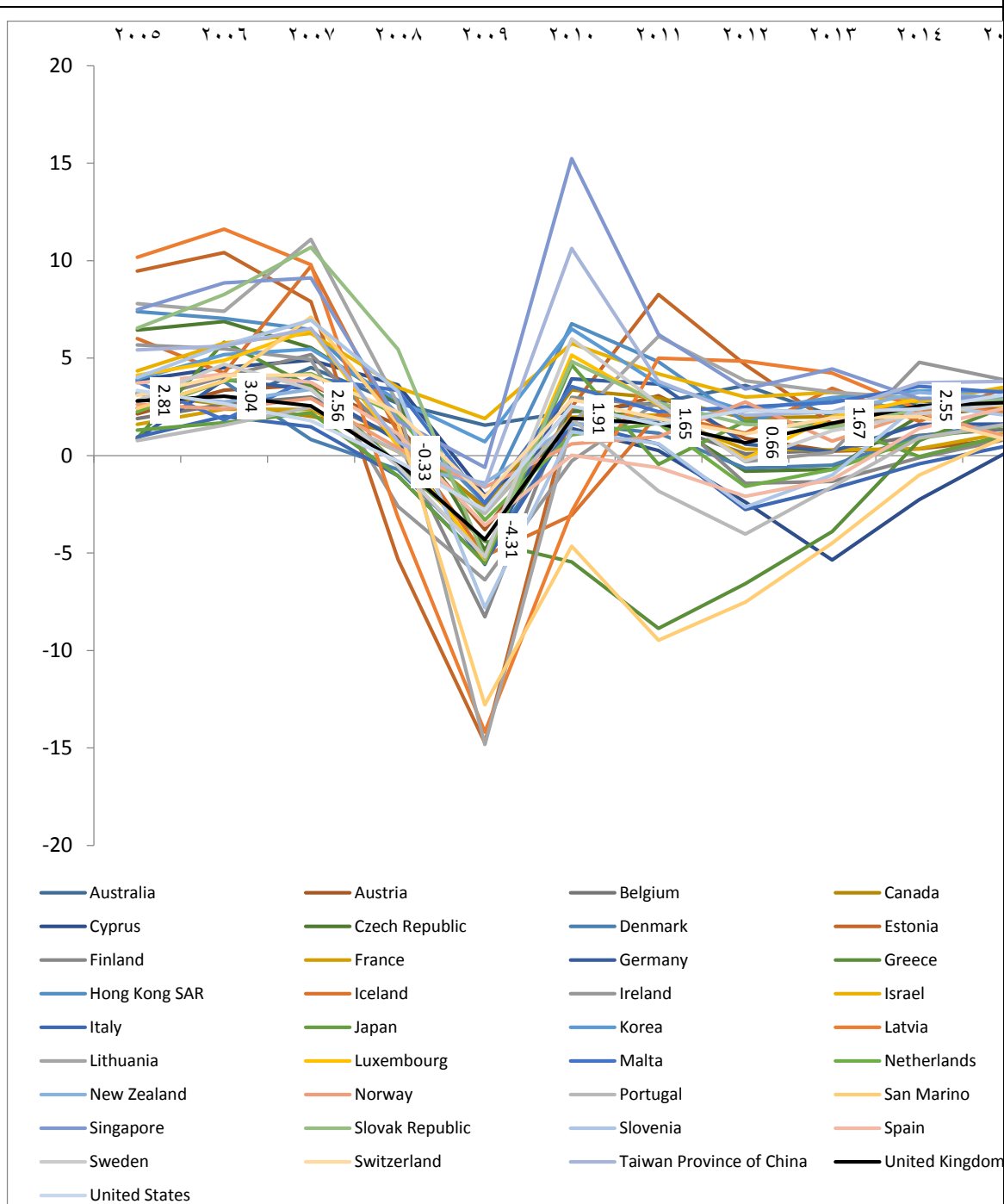
Statement	Strongly Disagree	Disagree	Not Sure	Agree	Strongly Agree
Corporate governance and performance:					
1- The increase in shares that are freely available to the investing public is positively related to good corporate performance.					
2- Separating positions of chairperson and CEO has a positive effect on performance.					
3- Corporate governance enhances the managing body's ability to perform by connecting executive remuneration with finance-led conclusions.					
4- - Improving corporate governance improves answerability through frequent meetings of audit committee					
5- The increase in nomination Committee affects corporate performance in a positive way.					
6- Frequent meetings of the Nomination committee have a positive effect on corporate performance.					
7- A large audit committee can facilitate effective monitoring.					
8- A high percentage of independent non-executive directors in the nomination committee have a positive impact on corporate performance.					
9- The existence of many shareholders with an exceptionally large amount or value of stock sustains a good corporate governance system.					
10- Large sized boards are impediments to good performance.					

11- Increasing the number of non-executive directors is helpful to a firm's management.					
12- Frequent board meetings allow good monitoring and smooth management of a firm.					
13- An audit committee should contain a high ratio of non-executive directors.					
Corporate governance and risk: 14- The Audit Committee should ensure that the primary objectives and functions of the Risk management Committee are adequately and effectively achieved.					
15- Government-owned companies don't rely on managing risk that much since the Government almost never defaults					
16- An audit committee member must understand how the company's liquidity is being managed.					
17- A good corporate governance system ensures that the BOD's have sufficient information to make sound decisions on important matters such as statutory changes, disposing of asset, and so on.					
18- The type of the shareholder affects consequences of corporate capital risk.					
19- Board of Directors should develop a liquidity strategy consistent with the strategic objectives of the financial institution as a whole and disseminate it throughout the institution.					
20- Systematic liquidity risk increases with institutional ownership.					
21- Consideration of the most relevant company structure in managing risk-related errors at the board-level.					
22- Institutional owners exert a significant influence on risk management committee.					
23- The AC can understand the company's capital structure along with subsequent risks.					

24- The measurements of liquidity risk to be forwarded to the BODs, for monitoring the liquidity portfolio along with compliance with what is required by the government along with the yearly business plan					
25- An audit committee should make sure that management attempts to avoid the negative consequences of risk.					
26- An audit committee should ensure that all corporate objectives are adequately mapped against risk.					
27- The degree of ownership concentration has a considerable impact on the behavior of risk management committee.					
28- The board's commitment to risk oversight should be communicated effectively throughout the organization.					

Appendix II: Real GDP Growth Trends in the World Before, During and After the Global Financial Crisis (2005-2015) (%)

Table 1: Real GDP Growth in Advanced Economies Before and During the Global Financial Crisis (2005-2015) (%)



Source: IMF WEO Database.

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