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Corporate Governance Mechanisms and Bank Performance: Resource-based View

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Abstract

The high profile accounting scandals, for example, WorldCom and Enron, have intensely impacted the nation and world economies. These events had ignited the importance of implementing good corporate governance mechanisms for companies, including the banking sector in Malaysia. Using the resource based theory, this paper examined the corporate governance mechanisms specifically the ownership monitoring mechanism, internal control monitoring mechanism (board independence and board size), and regulatory mechanism (capital adequacy ratio) influence on the bank performance. The sample of 18 banks (from 2009 to 2013) was collected from Thompson Reuters Worldscope database. The regression analysis has been employed to accomplish the objective of this paper. Based on the results, regulatory monitoring mechanism was found to be a significant influence on bank performance. Findings from this paper would assist the Central Bank of Malaysia and the Securities Commission to formulate strategies for the banking sector to fully comply with the Malaysian Code of Corporate Governance 2012. In addition, banks in Malaysia would be able to identify resources that need to be prioritized in attaining higher performance.

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1. Introduction

Accounting scandals in the United States (U.S.) corporate world particularly the Enron and Worldcom invited debates on the integrity of corporate financial reporting. The widespread failure in financial reporting has largely been blamed on weak corporate governance mechanisms (Abdul Rahman, 2006). The Malaysian Code of Corporate Governance (MCCG) 2012 focuses on strengthening board structure and composition recognising the role of directors as active and responsible fiduciaries. The Code stated that the board of directors have a duty to be effective

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stewards and guardians of the company, not just in setting strategic direction and overseeing the conduct of business, but also in ensuring that the company conducts itself in compliance with laws and ethical values, and maintain an effective governance structure to ensure the appropriate management of risks and level of internal controls apart from taking care of the stakeholders' interest. Therefore, in ensuring the compliance with laws and ethical values, the requirement of timely and high quality disclosure for all companies has been included as the seventh principle in the MCCG 2012 and the Bursa Malaysia Listing Requirements. Disclosure is the foundation of any structure of corporate governance (Bhasin, 2012) which is generally found in most annual reports.

The objective of this paper is to examine the relationship between corporate governance and bank performance in Malaysia. Resource-based theory is applied in explaining the relationship between corporate governance mechanisms and bank performance. The investigation is based on the assumption that banks are involved in greater information asymmetries and complexity of business transactions are at a higher level when compared with non-banks (Andres and Vallelado, 2008). Business complexities can be in the form of loans quality that are not being clearly perceived, financial engineering that is not transparent, complicated financial statements, easily modified investment risk, or accessibility of perquisites information for managers or insiders. The relevance of corporate governance on banks is different from non-financial companies due to specific requirement by the Financial Services Act (2013) formerly known as Banks and Financial Institutions Act (1984). Besides, basis for banking sector is treated under greater information asymmetries and plays an important role in regulating the economies (Alexander, Baptista, and Yan, 2013).

1.1 Resource based theory

Resource-based theory suggests that the resources possessed by a firm are the primary determinants of its performance, and this may contribute to the sustainable competitive advantage of the firm (Wernerfelt, 1984). Corporate governance mechanisms are categorized as firm's resources (Barney,1991; 1996; 2001; Wernerfelt, 1984). The resource-based view is a basis for sustainable competitive advantage of a firm that consists of valuable, tangible and/or intangible resources at the firm's own used however; these resources are heterogeneous in nature and not perfectly movable without proper management (Barney et al., 2001; Barney, 1991). Proper management is related to an organization in having good corporate governance as it has become one of the most important elements in evaluating firm's performance and sustainability. The implementation of a strategy to achieve sustainable competitive advantage is unlikely to follow automatically (Barney, 2001). Even though the most common definition of corporate governance is as an institutional "best practice" but it does not mean that it can stand on its own to be the source of competitive advantage. Therefore, the role of board of directors is critical in determining the achievement of sustainable competitive advantage of the firm through corporate governance. It is supported by Abdul Rahman (2006) that the board of director is responsible to three primary roles that include monitoring/control role, service/expertise/counsel role, and resource dependence role. Resource-based theory requires the board members to facilitate the acquisition of resources such as capital and business partnerships that are critical to the success of the organization.

Wernerfelt (1984), cited that resource-based theory underlines the role of independent directors which is supposedly to bring the unique resources to the firm and it is the task of the management team to gather and deploy the unique assets of the independent directors to achieve the competitive advantage goal of the firm. Barney (1991) further contributes on the research and suggested that heterogeneity of firm's various resources determined the firm's sustainable competitive advantage. In an ever changing environment, organization must continuously acquire, develop and upgrade its resources and capabilities to maintain competitiveness and growth (Wernerfelt, 1984). Some researchers describe capabilities as luck (Barney, 1996), whereas others describe capabilities as experiential learning by organizations (Drago, 1995), and the more managerially inclined emphasize the role played by leaders of organizations (Lakshan and Wijekoon, 2012).

2. Hypotheses Development

Using the resource based view as an underlying theory, five hypotheses were developed in this paper:

2.1 Ownership