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CEO power and its effect on performance and governance: Evidence from Chinese banks

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ABSTRACT

This study investigates whether CEO power matters in Chinese banks. We find that the effects of four power dimensions on banks' performance and board structure vary in their own unique ways. The CEOs with structural power are negatively related to performance but positively related to gender-diversified boards. Moreover, CEOs with ownership power enhance performance but are negatively associated with professionalism and diversification in the boards. Banks that have CEOs with expert power perform well and have gender-diversified boards. Meanwhile, CEOs with prestige power are likely to appoint politically connected directors to the board.

1. Introduction

The CEO represents the top position in a firm. According to the psychological and sociological elements of hierarchy, status and power are two important bases of hierarchical differentiation (Magee and Galinsky, 2008). Considered to be primarily subjective, a status hierarchy is characterized by the ranking of individuals or groups according to the amount of respect accorded by others. A power hierarchy ranks individuals by the amount of resources they control. Thus, in this paper we investigate CEO power in Chinese banks. Bank CEOs have vast resources, and their power has a key role in a bank's strategic decision-making and allocation of capital. On the one hand, power can help CEOs to execute strategies efficiently that in turn enhance competitiveness, improve performance, and strengthen the governance structure. On the other hand, because "guanxi" is common in Chinese business operations, CEOs with strong power can approve an increased number of unqualified loans and therefore reduce a bank's credit quality. In such a case, a CEO with strong power may reduce a bank's performance and weaken monitoring. Do CEOs use their power to the benefit or detriment of their banks? To examine whether CEO power matters in Chinese banks, we focus on two important ways of exercising power in banks: performance and governance.

With the multiple dimensions of CEO power, Choe et al. (2014) find that the scope of power must be broadened for a better understanding of the effects of managerial power on the firm's performance. Thus, we follow Finkelstein's (1992) classification

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and adopt four dimensions to measure CEO power: structural, ownership, expert, and prestige powers. These dimensions help to highlight the effects of CEO power on performance and board structure.

The results from a sample of Chinese banks from 1999 to 2011 show that the effects of different power characteristics on banks' performance and board structure vary in their own unique ways. We find that CEOs with structural power are negatively related to performance but positively related to the diversification of the boards. Meanwhile, CEOs with ownership power enhance performance but are negatively associated with professionalism and diversification on the boards. Banks with CEOs with expert power not only perform well but also have gender-diversified boards. Although CEOs do not affect performance through prestige power, those with prestige power are more likely to appoint politically connected directors to the board. This result extends the study of Fan et al. (2007), which verifies that politically connected CEOs would substantially possibly appoint bureaucrats to the board of directors. We affirm that CEOs with prestige power may probably have strong social networks and would also possibly appoint bureaucrats to the board of directors.

The results of robustness checks indicate that the relation between CEO power and banks' performance is not subject to the lag term of CEO power, econometric specification, and external monitoring. We also find that CEOs with expert or prestige power are likely to have political ties. Moreover, politically connected CEOs enhance the effects of structural and expert powers on performance.

Claessens and Yurtoglu (2013) identify certain issues that require further study in their survey paper on corporate governance in emerging markets. Specifically, corporate governance of banks is key. This study contributes to an improved comprehension of CEO power in Chinese banks. Our results indicate that CEO power matters in Chinese banks. The CEOs exercise their power and affect performance and governance. The true relations among CEO power, performance, and governance appear to be complex. The four dimensions of CEO power behave independently of one another and affect performance and governance in their own unique ways.

The remainder of this paper proceeds as follows. Section 2 presents the literature review. Section 3 describes the data. Section 4 presents the effects of CEO power on banks' performance and board structure. Section 5 concludes the study.

2. Literature review

Powerful CEOs tend to maintain an opaque information environment. For instance, bondholders demand high yields because of the difficulty of monitoring managers in firms with powerful CEOs (Liu and Jiraporn, 2010). The research indicates that CEOs can use their power to extract high pay or private benefits (Albuquerque and Miao, 2013). Malmendier and Tate (2009) evaluate the effects of CEOs achieving superstar status from the performance of their firms and state that the firms with award-winning CEOs subsequently underperform relative to their prior performance and to a matched sample of non-winning CEOs. Thus, the first part of this study focuses on the relation between CEO power and performance. We investigate whether banks with powerful CEOs perform differently.

Although Ararat et al. (2017) argue that most firm-specific factors have little effect on firms' governance choices, Albuquerque and Miao (2013) present a contracting model of governance based on the premise that CEOs are the main promoters of governance change. They argue that different CEOs prefer different governance. Moreover, the influence of a CEO over the board can have an adverse effect on board oversight (Cheng et al., 2014). Fan et al. (2007) argue that firms with politically connected CEOs are likely to appoint other bureaucrats to the board of directors instead of directors with relevant professional backgrounds. We test this trait from the perspective of power and examine the association of CEO power with the degree of professionalism and monitoring in boards. Thus, the second part of this study focuses on the relation between CEO power and board structure. We investigate whether directors of the board present different levels of professionalism and monitoring in banks with powerful CEOs.

Because of the multiple dimensions of CEO power, the scope of power must be broadened for an improved understanding of the effects of managerial power on a firm's performance (Choe et al., 2014). Different power characteristics behave independently of one another and influence performance in their own unique ways (Chaganti et al., 2001, 2005). For instance, Tien et al. (2013) apply the agency and managerial power theories and find that CEO power from a directorship positively affects performance; CEO power from duality negatively affects their pay; CEO power from tenure positively affects their pay; and composite power negatively affects short-term pay.

3. Data

We use the list of financial institutions from the China Banking Regulatory Commission[1] as the basis for our sample. We obtain a profile of each bank's CEO and directors from the "Profile of Directors and Senior Managers" section of the bank's annual reports from 1999 to 2011.

[1] The list of financial institutions from China Banking Regulatory Commission can be obtained from the following website: http://www.cbrc.gov.cn/chinese/jrjg/index.html.