Corporate governance in banking institutions

~ *Ph. D. Student* **Iyad Isbaita** *(Academy of Economic Studies, Bucharest, Romania)*

E-mail: eyad247@hotmail.com

Abstract: *The analysis of corporate governance within institutions is a top subject right now. This concept currently de-fines a central and dynamic aspect in terms of economic reality, being increasingly present in many countries of the world. In the context of a modern economy, where all companies are facing changes due to the famous effects of the fourth industrial revolution and the crises caused by the Covid 19 pandemic, those who need to survive must be able to adapt immediately and operate at the highest level of efficiency. The ability to adapt to these challenges of the national and international markets depends on both managerial and leadership capabilities, as well as the general structure and characteristics. Achieving maximum overall performance of companies is the microeconomic goal of the "new economy". The entire activity of financial institutions is built around the correct assessment and management of risk. Thus, risk management, ownership structure, motivation and remu-neration of the general manager were the central elements found in research papers on "corporate governance of banks". The results of the literature study on risk management suggest a continuous increase in the relevance of this topic. The aim of the paper is to present the topic of corporate governance within the banking institutions. One of the limitations of this study is the lack of analysis in the current context triggered by the COVID-19 pan-demic. This pandemic is already having effects in terms of corporate governance, but also risk management as a whole. From the way banks approach and reanalyze customer relations, we see that the effects of the pandemic are already here.*

Key words: corporate governance, banking, leadership, economic efficiency

JEL: G20, G30, G32, G34

1. Introduction

The analysis of corporate governance of banking institutions is a topical issue. This concept currently de-fines a central and dynamic aspect of the economic reality, being more and more present in many countries of the world (Spătăcean and Ghiorghiță, 2017). The entire activity of financial institutions is built around the correct assessment and management of risk. Thus, risk management was one of the central elements found in the research papers on "corporate governance of banks". The results of the study of the literature on risk management suggest a continuous increase in the relevance of this topic as it has been amplified by the recent financial crisis, the Fourth Industrial Revolution and the pandemic caused by Covid 19 (Niculae, et al., 2010; Burcea, et al., 2011; Toma and Grădinaru, 2018).

Most of the work is focused on the functions of the risk department chief manager within the bank. Added to this have recently been concerns about safety and security at work for employees, managers, suppliers and customers. Thus, developing is a department with precise responsibilities and good practices recently developed in connection with the safety and health of those involved. These aspects have greatly influenced the way man-agement works in general, and especially in banking institutions. In their case, aspects such as work forced the management to adapt both its communication and the distribution and control of tasks. The aim of the paper is to present the topic of corporate governance within the banking institutions.

One of the strategies to thrive, to avoid spectacular bankruptcies, financial crises and considerable differ-ences between the compensations granted to directors and the company's performance is represented by corpo-rate governance (Ionescu, et al., 2015). Given that corporate governance is closely linked to the norms, traditions and behavioral patterns developed by each legislative system as defined in the Preda Report (Preda Report, 1999), it is important to analyze the differences between different practices in order to choose the most competi-tive systems.

2. Literature review

Corporate governance is the way in which a company's financial resource providers ensure that they will receive the benefits they expect by making this investment (Shleifer and Vishiny, 1997). The use of this system of rules and regulations benefits companies by attracting new investors, by increasing economic performance, long-term competitiveness, better risk management of the company and last but not least by advertising the com-pany.

In the context of the modern economy, where all companies are facing changes due to the effects of the Fourth Industrial Revolution, those who want to survive must be able to adapt immediately and operate with them at the highest level of efficiency and effectiveness possible. The ability to adapt to these challenges of the na-tional and international markets depends on both managerial and leadership capabilities, as well as the structure and the general characteristics of the company (Obrad, et al., 2011).

Achieving the maximum global performance of companies is the microeconomic goal of the "new econo-my". To achieve this goal, we need to build effective corporate governance (Apostol, 2015). The efficient func-tioning of the banking system involves a threefold role: the efficient allocation of depositors' cash to the real sec-tor, the making of payments without syncope in the economy and the prudent management of financial risks. When one or more credit institutions fail to adequately perform these

basic functions, the economy may suffer significant losses (Moinescu, 2015).

Corruption in the lending activity, financial fraud or reduced banking efficiency may be the result of a weak and deficient corporate governance mechanism (Pîntea, 2018). Good corporate governance is also based on effective risk management. The public's trust in banks, at individual level, but also at global level, in the banking system depends on the efficiency of their administration. For example, in the Republic of Moldova, in the case of the global financial crisis triggered in 2007, the excessive accumulation of risks was partly caused by the defi-ciencies of the corporate governance of financial institutions and especially by the actual deficiencies of banks. The lack of effective control mechanisms ultimately led to too many risks being assumed by most credit institu-tions, which led to very difficult economic situations (Clichici, 2015).

Following the global financial crisis of 2008-2010, government agencies have focused on establishing rules and regulations to ensure a more accurate risk assessment. These have resulted in guidelines for good prac-tices on principles of sound corporate governance (McConnell, 2012). To these have recently been added a num-ber of regulations related to the safety of employees and customers in the context of the pandemic caused by Covid 19. These rules of good practice complement the already existing documentation within the companies.

In many countries, national authorities have put in place various measures to improve regulations and oversee the implementation of corporate governance in order to reduce risks in financial institutions. These measures were chosen in order to have a solid environment, clearly established roles and accountability of the boards of directors (Brogi, 2011).

3. Research methodology

The scientific research of the specialized literature is based on a quantitative approach of the research thematic, which aims to perceive and apply the theoretical concepts of corporate governance in practice, using the positivist method, which involves defining the research topic, setting hypotheses, collecting, processing and data analysis as well as presentation of results.

The method makes it possible to identify a general conclusion, based on the interpretation of the analyzed studies. The research topic of the article is the corporate governance, with its main factors for reducing the ef-fects of different crisis in banking institutions.

For this article I have chosen as a research method, one, that is a mixed form, which combines a secondary research based on the study of the bibliography in combination with the new situation created by the Covid 19 pandemic. It was chosen to identify good managerial and administrative practices within banking institutions. In addition, the aim was to analyze the satisfaction of stakeholders' expectations.

In connection with the professional skills and the remuneration of the management, which must take into account both the satisfaction of the shareholder requirements and a correct risk management, the analysis of the situation of the last financial crisis, the Covid 19 pandemic and the impact of the Fourth Industrial Revolution were taken into account.

The evaluation presented in the literature regarding the effects of corporate governance was another factor followed in the research. After selecting the main bibliographic sources, their analysis followed. This has resulted in the identification of the following main factors, which define corporate governance as widely as possible. These

factors are: risk management, the structure of the property with the separation between the control and the executive function and the remuneration of the general manager.

The hypothesis formulated and verified during the analysis of the selected bibliographic sources, was that the factors presented earlier are those that define corporate governance after the financial crisis. Recent events emphasize the need to complement them with elements related to safety and health at work.

4. Results and discussions

Traditionally, the emphasis is on equity governance, meaning the conflicts of interest between owners and management, and / or between shareholders holding control packages and minority shareholders. In addition to capital governance, debt governance issues are of particular importance to banks (Heremans, 2007).

Differences between the rules and operating rules of banking institutions within the European Union and non-European states are one of the factors that determine their effectiveness. The literature also shows that banks in which the chief risk manager reports directly to the board of directors and not to the CEO have significantly better results both in terms of performance and the risk measures they implemented (Ellul and Yerramilli, 2013).

Mongiardino and Plath (2010) emphasize the need for a dedicated level of leadership, that can be a man-ager or a risk committee composed of independent members. In addition, they point out that the chief manager of the risk department should be part of the bank's executive committee (Mongiardino and Plath, 2010). In 2013, this theory is complemented by the recommendation to improve risk communication and assessment and to pro-pose the establishment of independent, specialized national committees or working groups to monitor risk-related activities within banks (Barakat and Hussainey, 2013). Another aspect of the risk management literature in banks is focused on the importance of CEOs and their impact in determining performance capabilities and risk profile in banks.

A number of papers highlight the insufficient and poor risk management in financial institutions (Brogi and Lagasio, 2018). Risk management issues have attracted the attention of both financial institutions and na-tional and international bodies.

The boards needed these measures in order to streamline their work. The measures implemented focused on the revision of existing rules and regulations, on the procedures for organizing, managing and transmitting information and last but not least on the tasks of management, including the relation with the board of directors. Through these regulations, the board of directors also receives direct responsibility related to risk management. By introducing these measures, positions were also created with specialized personnel to fulfil the position of Chief Risk Officer (CRO). The main task of the chief manager of the risk department or the risk management committee is to oversee all risks assumed by the financial institution. This practice is especially common for large financial institutions, which have a board of directors (OECD, 2017).

Government institutions have encouraged financial institutions and investment firms to implement proce-dures and standards of good practice through which management bodies within the structure of each entity en-sure effective risk oversight,

promote a sound and effective culture of lending, investment, respectively assuming all the risks specific to the activity carried out. These measures have been established to allow effective monitor-ing and control by government authorities related to risk-taking by banks, other financial institutions, investment firms, etc. Monitoring activity is not limited to risk monitoring, but extends to internal governance within banks, financial institutions and investment firms.

Risk reduction measures have been implemented globally. Within the European Union, the activity of monitoring risk and internal governance implemented can be supervised by specific bodies, not only within fi-nancial institutions and investment firms, but also within the national bodies of the Member States. Even if many measures were taken after 2013, we cannot say that we currently have a perfect solution related to risk manage-ment and internal governance, neither at the level of institution / society nor at national level.

An important element for improving the situation refers to the independence that the risk manager must enjoy, which must not be pressured by the wishes of the sales department or other minor interests. In order to be able to correctly assess the extent to which certain procedures and rules have been followed, it is also necessary to ensure audit rules. At national level, in various countries, there is a need to improve the audit procedures of financial institutions and investment firms in relation to the rules and good practices related to governance, risk management and risk culture adopted by each. Monitoring involves not only verifying the existence of proce-dures and rules of good practice, but especially how they are implemented and observed in the day-to-day work (BCBS, 2015).

The entire academic literature emphasizes the special importance of ensuring the most sound and correct risk management in all financial institutions, banks, investment companies and beyond.

Another very important aspect that corporate governance must correctly include is the one related to the separation of property from the exercise of the control function. Thus, another second element analyzed in the academic literature related to corporate governance is that of ownership structure (Shleifer and Vishny, 1997). Almost 100 years ago, the importance of separating the control decision was highlighted in the academic litera-ture (Berle and Means, 1932).

The study, published by Berle and Means, points out that those who are concerned with business stability and risk minimization cannot be the same persons who want to maximize their wealth. Thus, arose the discussion of the possibility of separating the "property" from the control necessary for the smooth running of enterprises, without devastating effects on the various stakeholders (Fama and Jensen, 1983).

In addition, it has been observed that an unclear and unstable ownership structure leads to a negative per-formance of companies. The task of management is to maximize the profit of the owners and to satisfy their in-terests (Jensen and Meckling, 1976).

If the property is separate from the control, we have employees who assume the monitoring and control of events. These employees are not owners, and their interests are not identical to those of the owners.

The ownership structure must be able to be properly monitored, this being one of

the solutions proposed in literature, as being the one that can reduce costs (Shleifer and Vishny, 1997). Organizations have horizontal or vertical structures.

Within organizations with horizontal ownership structures, there are certain problems between majority and minority shareholders, and in those with vertical structures, problems arise between managers and shareholders. However, the latter find their solutions much easier (Vermeulen, 2013). Aspects related to the difficul-ties encountered in organizations with horizontal structures were also analyzed at the level of global organizations, where various solutions were sought.

The effects of ownership unbundling are still at the center of several debates (OECD, 2017). In the studied materials we did not find a solution that would have determined all the variables and could propose the ideal structure, which determined us to analyze this aspect by comparing several cases from different countries. A clear relationship was determined between performance, especially in the case of banks and shareholder involvement in the organizational structures of the institutions. In the analysis related to property, a distinction is made between two aspects, namely: the concentration of property and the category of owners. Concentration of property has advantages in terms of risk reduction (Shehzad, et al., 2010).

Most of the works related to the ownership structure can be classified into two different groups, namely: works analyzed from a "quantitative" point of view (e.g., concentration of ownership) and a "qualitative" point of view (e.g. type of owners). Regarding the first dimension, the result is related to the fact that the concentrated property helps an enterprise have a better monitoring function, leading to reduced risk and improved performance (Azofra and Santamara, 2011). Not all papers studied have the same conclusion, but the strong relation-ship between concentrated ownership and banking risk-taking, especially during the financial crisis in the US, is confirmed (Beltratti and Stulz, 2009). A negative relationship between ownership concentration and bank per-formance is presented in some papers. This is demonstrated by measuring the market-based performance of banks (Busta, et al., 2014). The authors also note that their result is strongly linked to the institutional structures in which the bank operates. They showed stronger negative effects for banks operating in Germany, France and other countries with similar legal systems. If we refer to the "qualitative" analysis of the ownership structure in banks, the main result obtained is that the risks are lower when the interests of the owners converge with those of the management (Berger, et al., 2014). This result is complemented in some works that do not limit the positive effects of the owner manager only to the decrease of risk, but also refer to the increase of performance (Westman, 2011).

Another relationship studied in the literature is the position of the CEO (Chief Executive Officer) in the ownership structure of the bank. In other works, state ownership is analyzed from the perspective of the owner-ship structure within a bank (Iannotta, et al., 2013). Institutional shareholding was analyzed as another variant for the ownership structure within a bank (Barry, et al., 2011). An unequivocal conclusion could not be drawn as a result of studying the literature on a clear relationship between a particular ownership structure and their banking risk or performance (Lagasio, 2018).

A topic studied extensively refers to the impact that the "position of duality of the general manager" has within a bank. This refers specifically to the general manager's position as both "chairman of the board" and "general manager" (Cornelli, et al., 2013; (Simpson & Gleason, 1999); (Rachdi and Ameur, 2011). This dual posi-tion has not been proven to have positive or negative effects on a bank's performance.

A third element discussed in corporate governance is that related to the benefits obtained by the manage-ment of the institution. In the literature there is a consensus that the type and level of compensation granted to managers motivates them to be more open to taking risks (Chaigneau, 2013). Thus, this topic is one of the most debated in the case of corporate governance.

The topic is debated by shareholders, national or international control bodies, but also by the media (Ra-jan, Seru, & Vig, 2008). These debates about the benefits of managers focus mainly on the benefits obtained by the CEO , either in a private company or in a financial institution (Tian and Yang, 2014).

From the studied materials it resulted that the remuneration of the General Manager should ensure stability and continuity in the long-term activity of the financial institution and not serve short-term interests, which may destabilize the organization (OECD, 2017).

Regarding the compensation, we discuss in particular the variable part of it, and the theory suggests that it can be considered a tool to bring the interests of managers closer to those of shareholders (Grove, et al., 2011). The results of these forms of remuneration are more effective for executives and top management (Acrey, et al., 2011).

If in the older materials we notice a strong focus on the benefits and remuneration of top management, to-day more attention is paid to the directors of the risk department (CRO). In this case, it is analyzed to what extent a relationship can be established between the decrease of the assumed risk along with the increase of the com-pensation level of the director of the risk department (Aebi, et al., 2012). However, even in this area of corporate governance, no conclusive relationship has been identified. The study, which treated the relationship between the bank's performance and both forms of top management incentives, but also the connection with the ownership structure could not prove their existence (Fahlenbrach, 2011).

The theory of managerial power, on the other hand, presents negative aspects of the top management re-muneration system with variable components. Within this theory it is revealed that this variable component can even have negative effects, by deviating the interests of top management from those of shareholders (Bebchuk and Weisbach, 2010).

The remuneration and benefits granted to managers must be in line with the objectives of the financial in-stitution and closely related to the bank's performance and the level of risk assumed. A guide to regulations and good practices related to the benefits and remuneration of managers has been developed at European Commis-sion level.

These benefits and remunerations must also be discussed and analyzed during the meetings of the board of directors of each bank. Based on the annual activity reports, the level of achievement of the objectives by the management team can be discussed and thus the level of benefits and remuneration granted should result accord-ing to the pre-established norms and regulations.

5. Conclusions

Studying the fundamentals of corporate governance within financial institutions, banks and investment companies from the perspective of risk management, ownership structure and remuneration and benefits granted to management was an important step in structuring the research topic. This field of research has developed a lot in the last 40 years, but it has known a special dynamic in the last decade.

Today is an important moment in the review of the rules and regulations applied through corporate gov-ernance, the same way like it was after the last economic crisis from 2008 to 2010. In many countries, national authorities have introduced various measures to improve regulations and monitor the implementation of corpo-rate governance in order to reduce risks in financial institutions and to improve health and security regulations.

These measures were mainly linked to a new approach to risk and security management. The norms of good practices implemented within the corporate governance in banking institutions and not only have been sup-plemented, now, with the elements related to occupational safety and health.

Risk management, ownership separation and ways of remunerating and assigning tasks to the general manager remain today relevant factors of corporate governance, as demonstrated by the analysis of the selected documentation. Compared to the situation analyzed after the recent financial crisis, banking institutions have had to adapt much faster as a result of the Covid pandemic 19. In my article I presented and analyzed important ele-ments that occurred after the financial crisis because the current situation caused by Covid 19 is also a situation of a crisis, even if this time it is a global health crisis and not one of a financial nature.

The same factors were again in the attention of the companies and the same problems were discussed. Within organizations with horizontal ownership structures, there are certain problems between majority and mi-nority shareholders, and in those with vertical structures, problems arise between managers and shareholders. A controversial aspect in the analyzed studies is the role and approach of risk management elements by managers. Now, we have the discussion of the safety officer.

The general manager has today more factors to take into consideration for improving stability and eco-nomic development. The remuneration and motivation of the CEO should ensure stability and continuity in the long-term activity of the financial institution. The current research is the first needed step for defining the main factors which influence the corporate governance in the situation of a crisis.

One of the limitations of this study is the lack of analysis in the current context triggered by the COVID-19 pandemic. This pandemic is already having effects in terms of corporate governance, but also risk management as a whole. From the way banks approach and reanalyze customer relations, we see that the effects of the pandemic are already here. For this I planned to extend this research with an empiric one, for having a better understanding of the impact of the current threats.

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