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Corporate Governance and CEO Gender on the Relation between Innovation and Firm Performance in the UK financial sector

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Abstract

Corporate Governance was a matter of focus of many studies during the last decade, especially after the financial crisis in 2007. With a particular emphasis on whether the quality of Corporate Governance practices does impact a company's innovative investments and performance. In the same context, This Study will focus on gender diversity within a corporation, due to its relation to corporate choices which has seen light in recent years, by scholars arguing of a positive relation between female board representation and firm performance.

However, the effect of both corporate Governance and CEO gender on the relation between Innovation and firm performance remains unclear. The current study will investigate the roles of these two variables on the relation between innovation and firm performance in the period of pre and post financial crisis of 2007, to explore whether there is a difference in their effect based on the environment in which the company operates.

Keywords

Corporate Governance – Gender – CEO - Innovation – Financial performance

Track

Corporate Governance

Word count: 2355

1. Introduction

Existing literature focuses on the direct effect Corporate Governance has on a firm's innovation and a company's performance individually. At this effect empirical results mostly attest of a positive relationship between Corporate Governance and both Innovation and firm performance alike (Chemmanur and Tian, 2017). However, this cannot be generalised as some research studies considering some aspects of Corporate Governance, show contradictory results: Honoré, Munari and de La Potterie (2015) researched the effect of some governance practices like Anti-Takeover Devices on R&D intensity, they concluded that governance practices that are designed to respond to the short-term expectations of financial markets might prove to be detrimental to long-term R&D investments. In addition to that, the critical analysis of the literature shows that most of the studies on Innovation and performance of firms targeted non-financial firms, and little is known about innovation within the financial sector and how it is linked/ or not to the financial performance of banks and financial institutions, and even less is known about the effect of Corporate Governance on Innovation and performance in the financial sector alike. The effectiveness and accountability of Corporate Governance mechanisms on firm performance continue to be a debatable subject (Mollah and Zaman, 2015). The interest in the relationship between governance and performance, particularly the performance of banks and financial institutions, has notably increased following the global financial crisis (Aebi et al., 2012; Pathan and Faff, 2013). However, only the direct impact of corporate governance on the performance of banks was looked at, and no studies empirically investigated the indirect effect Corporate Governance has on firm performance. This study will accordingly fill in this gap by investigating the role of Corporate Governance as a moderator of the relation between innovation and financial performance within banks and financial institutions.

Similarly, over the last decade, gender diversity has become the centre of attention in Corporate Governance research. In fact, a considerable interest in recent years is attributed to the effect of the CEO Gender on strategic decision making, hence on the company's performance. Some capital markets are accordingly urging to enact gender quotas on boards, whereas others are more of the opinion of a 'soft' approach or best practice approach where advice and recommendations are given to the respected firms in terms of their gender diversity policy. (Rose, 2007; Chapple and Humphrey, 2014; Terjesen et al., 2015).

The policy issues of gender diversity does not lay in the necessity or not to have more women involved at management level, as much as it is on what the financial attribute that the introduction of more women on boards would add to the corporation and the market as a whole (Chappole and Humphry, 2014). And again, like corporate Governance mechanisms, few empirical studies have been conducted to highlight the indirect effect the gender of the CEO has on the relation between Innovation and firm performance. (Cooper,2000 ; Klomp and Van Leeuwen,2001; Calantone et al.,2002 ; Craig, Dibrell and Neubaum, 2014).

Therefore, this study contributes to the existing literature by identifying the moderators that affect the strength of the relation between Innovation and Firm Performance, and suggesting a conceptual framework that includes all the variables and shows the relation and the effect exercised by each variable.

The aim of the paper is to empirically investigate the moderating effect of Corporate Governance Parameters and CEO Gender on the relation between Innovation and Firm Performance. In order to achieve this aim, the following objectives are to be met:

1. To critically evaluate the relevant literature on Innovation, performance, corporate governance and gender diversity within the financial sector.

2. To Identify factors effecting relation between Innovation and Performance

3. To examine best variables to represent Innovation within the financial sector, Corporate Governance and Performance measures.

4. To develop a framework that presents the variables' relationships and the moderating effect of Corporate Governance and CEO gender.

2. Literature Review

The recent studies have reported a considerable interest in the effect of gender diversity on corporate choices and strategic investment. With most studies conducted on the US and European market, Huang and Kisgen (2013) and Levi et al. (2014) find that female executives are more cautious than their male peers in making important corporate decisions. Liu and Wei and Xie (2014) extended the literature and investigated the effect of board gender diversity on firm performance in the Chinese market. They document a significant positive relation between the presence of female in the board and the firm performance. They moreover add that the executive role of female is more important than their monitoring role. Similarly, Chippole and Humphrey (2014) address the link between gender diversity and a firm financial performance, in response to the Australian Market Operator statement on the positive association between the improvement of gender diversity within boards and the increased financial performance:

"Research has shown that increased gender diversity on boards is associated with better financial performance, and that improved workforce participation at all levels positively impacts on the economy. (ASX, 2010 cited by Chappole and Humphrey (2014))

The researches investigate whether gender diversity within the board was related to firms' performance, as well as the existence of a within industry effect. They report no association between the number of women in the board and performance. Moreover, they found weak evidence of a negative relation between the number of women on boards and financial performance in some industries, whereas in others, notably in basic materials and consumer goods industries, there small evidence that the presence of at least one woman in the board is linked with higher company return. Moreover, the researchers argue that big and well established firms can afford diversity within the board with the presence of more than one female as a director.

On the other hand, the study of gender diversity and corporate governance concludes in findings that are subject to the strength of Corporate Governance Practices implementations. With some arguing that board gender diversity could partially offset weak corporate Governance practices (Gul et al., 2011), whereas Adams and Ferreira (2009) argue that in well governed firms, gender diversity can be detrimental to firm value because of unnecessary over monitoring.

Researches on gender diversity effect mainly focused on the board composition and highlighted the gender diversity impact on enhancing the monitoring process (Molero, 2011). However few studies focused on the implication of the CEO gender on firm value and performance. Faccio, Marchica and Mura (2016) investigated the relation between managerial traits and corporate choices at CEO level. They reported that firms run by female CEOs exhibit lower leverage, less volatile earnings and higher chance of survival compared to firms run by male CEOs. This comes in line with the work on Khan and Vieito (2013) who again argue that on average the gender of the CEO matters in the firm performance, in that, the researchers document that firms managed by female CEOs are performing better than firms that are managed by male CEOs.

In contrast, Sila, Gonzalez and Hagendorff (2016) raise the question on whether the increase of the number of females in the board would lead firms to engage in less risky investment or not. The researchers concluded with no evidence that female representation in the board influences firm risk.

So, the existence of a direct relation that links a firm's financial performance, investment strategy and risk taking to the degree of gender diversity in boards and the evidence supporting that remains ambiguous in the literature. In fact, numerous studies that studied the direct causality between diversity and financial performance concluded with inconsistent and mixed empirical results (Sarhan et al., 2018)**.**

The focus on gender diversity within the board is of no surprise due to the importance played by the board - and other corporate governance parameters- not only in controlling and monitoring, but also in regards of strategic investments like innovative projects and hence the added value to the firm. Similar arguments are to be addressed regarding the importance of Corporate Governance particularly after the recent financial crisis where an extensive interest was given to shed the light on the extent to which Corporate Governance failures contributed to the collapse of the banking system. Notably, issues dealing with the effectiveness of bank boards in monitoring and controlling bank risk, the structure of the executive pay that was judged too excessive, therefore, promoting aggressive risk taking, and the adequacy of bank risk management were raised and discussed (Srivastov and Hagendorff, 2016 ; Bebchuk and Spamann, 2009 ; Kirkpatrick, 2009 ; Kashyap, Rajan and Stein, 2008).

Previous studies focused mainly on direct affects between corporate governance and innovation (O'Connor and Rafferty, 2012), innovation and firm performance and corporate governance and firm performance (Daily, Dalton and Rajagopalan, 2003; Connelly et al.,2010). Few studies have been conducted to address the factors that affect the strength and the significance of the relation between innovation and firm performance (Jimenez-Jimenez and Sanz-Valle, 2011; Saunila, Pekkola and Ukko, 2014; Chen et al., 2015). The lack of empirical evidence attesting of the role played by corporate governance practices and gender diversity in strengthening the relation between innovation and financial performance remains particularly true in financial sector, given that the majority of the researches were conducted on nonfinancial firms.

3. Methodology

The approach adopted in this study is a quantitative approach. The research being developed based on a critical and systematic analysis of the existing literature and a conceptual framework has developed which shows the relation between Innovation and Firm
Performance (see Figure 1), but also the different factors that intervene in this relation.

In fact the study is initiated by conducting a critical review and analysis of the existing literature on relevant theories around Innovation, Corporate Governance and differences in behaviour towards risk taking hence strategic investment, and the impact on the firm's performance.

The first stage of the study comprises the identification of the factors that moderate the relation between Innovation and Firm Performance based on theories mainly Agency theory that governs the principle – agent relation. Since Agency theory does not take into account the environment in which the firm operates, therefore investigates only the direct effect an independent variable has on a dependant variable, the study also utilises the contingency theory that advocates an open system perspectives and rejects the view of universal best practices, in other words: rather than considering only the direct effect a variable has another, the contingency theory suggest an approach where the impact of an independent variable (Innovation) on a dependant variable (Financial performance) is contingent on the level of a third variable (moderator or a mediator).

The framework is tested empirically through the obtention of empirical data. Since the study is based on the UK Market, accounting and financial data will be obtained from Fame database. The latter will be tested against primary data obtained through a survey conducted on UK banks and financial institutions. (Bryman and Bell, 2015).

Research Question

The study will attempt to answer the two following questions:

R.Q1: What are the factors that drive innovative investments not benefit all companies' performance alike?

R.Q 2: Do Corporate Governance and CEO Gender moderate the relation between Innovation and firm performance?

Hypotheses:

H 1: Board independence has a positive impact on the relation between Innovation and Performance

H 2: CEO Duality negatively impacts the relation between the two variables.

H 3: In highly performing firms, the effect of corporate governance in shaping the relation between innovation and performance is more important than within the less performing corporations.

H4: Executive share ownership positively impacts the relation between innovation affirm performance.

H5: Board ownership positively impacts the relation between innovation and firm financial performance.

H6: Employee share ownership positively impacts the relation between Innovation and firm Financial performance.

H7: Positive impact of female CEO on the relation.

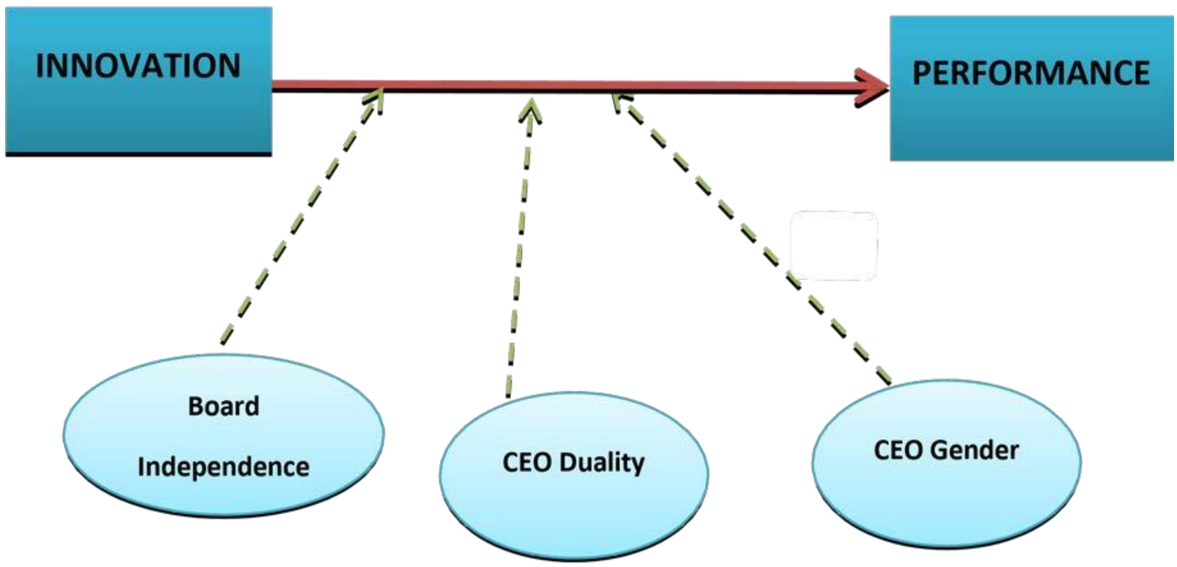

Figure 1: Conceptual Framework for Corporate Governance and CEO Gender on the relation between Innovation and Firm performance

4. Conclusion

This paper investigates the effect of Corporate Governance practices and CEO gender on the relation between Innovation and firm financial performance within the UK financial sector.

It extends the literature and the knowledge on how gender diversity affects corporate strategic decision making and performance. It adds on to the existing findings by investigating the indirect effect the gender of the CEO exercises on the relation between Innovation and Firm performance.

Moreover, with the documented importance of Corporate Governance practices on both Innovation and the firm's performance, the current study will also attempt to shed the light on Corporate Governance parameters that moderate the relation between Innovation and Firm performance.

5. Next steps of research

Currently, a critical analysis of the literature has already been conducted, with the identification of a research problem and research gap that needs to be investigated.

The first stages of the proposed conceptual framework are in place, and so is a more in depth analysis of the methods used in the literature. The next step would be data collection and analysis to derive findings and explain the relationships in order to conclude the study.

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