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# SITTING ON THE FENCE: DOES HAVING A ‘DUAL-DIRECTOR’ ADD TO BANK PROFITABILITY?

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# SITTING ON THE FENCE: DOES HAVING A 'DUAL-DIRECTOR' ADD TO BANK PROFITABILITY?[3]

This paper investigates how combining positions between the board of directors and top-management affects bank profitability. We use 2010 bank-level data from 112 countries. Our results suggest that combining positions reduces both ROE and ROA of banks. However, for banks in developing countries, the influence proves to be positive. We also show that the higher the proportion of the board members who simultaneously hold a managerial position, the lower the profitability of the bank. This effect is observed both for developed and developing countries.

JEL Classification: G21, G34
Keywords: corporate governance, banks, profitability

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# Introduction

Bank governance involves a set of decisions by which managers and executives can influence both the current soundness and profitability of the financial institution and the long-term prospects of its development. The efficiency of managerial decisions depends not only on the competence of employees who implement them, but also on the hierarchy of responsibility – meaning, on corporate governance system – arranged in the bank.

Corporate governance is commonly understood as the theory and practice of relations between owners and managers of a corporation. Thus, according to Shleifer and Vishny (1997), "Corporate governance deals with the ways in which suppliers of finance to corporations assure themselves of getting a return on their investment" (p. 737). Monks and Minow (1995) also define corporate governance as "the relationship among various participants in determining the direction and performance of corporations" (p. 8).

Actually, the phenomenon of corporate governance is closely related to the concept of ownership and management separation. The concept appeared in application to large corporations where it is almost impossible for numerous shareholders to make strategically important decisions in coordination. The decision-making process became more consistent as experienced and properly educated managers were involved in corporation governance. However, in addition to benefits, separating ownership and control has a significant drawback: The pursuit of various interests by managers and owners engenders the agency problem. Instead of maximizing shareholder returns, managers may strive to increase the volumes of sales in the pursuit of bonuses in the current period, even if such a solution leads to a decrease in company profits or impedes achieving long-term goals. In other words, shareholders who act as "principals" may face a loss of wealth due to the fact that "agents" (managers), in the pursuit of higher wages and reputation, may stand for extremely risky or unprofitable decisions. In order to not lose potential benefits, the shareholders have to control the management's actions, meaning that the company owners are responsible for agency costs (Jensen and Meckling, 1976).

In practice, the separation of owner and manager interests can be interpreted in terms of the interaction and division of powers between the Board of Directors, which may be considered as representative of shareholder interests, and the executives or top management. Although the powers of the directors may vary among companies, overall responsibilities usually include strategy development, control over its performance, and deciding the payment of dividends to shareholders. Managers are those who are responsible for the quality of the strategy

implementation and day-to-day operations. However, the separation of powers among representatives of these groups is not always obvious.

Corporate governance efficiency in banks falls short of thorough examination in the empirical literature as the majority of studies devoted to the structure of the Board of Directors exclude financial firms from the sample, concentrating only on non-financial companies. However, just as in the studies dedicated to the non-financial sector, analysis of the peculiarities of corporate governance in the banking industry is conducted to clarify how the individual characteristics of managers and structural features of the Board of Directors affect bank operations.

The problem of efficient distribution of powers in banks among the directors and executives on different levels is currently attracting much attention from both regulators and researchers. In particular, since 1999 the Basel Committee on Banking Supervision has published papers devoted to the corporate governance practices in banks. The most recent of these documents – *Principles for Enhancing Corporate Governance* – was published in 2010. It contains recommendations on the distribution of responsibilities between structural units of banks, the hierarchy of director responsibility, and the disclosure of information about the composition of a Board of Directors. One of the key issues in the document is the description of the functions of a Board of Directors. Specifically, when describing the powers of a Board Chairman, it states that in case one person combines the positions of Chairman and CEO, the bank should impose more control over the decision-making process within the Board. In a number of countries, such as Angola, Luxembourg, Mexico, Portugal, Slovakia, and Turkey, this combination of positions is prohibited by law. However, the Basel Committee does not offer any recommendations about whether combining positions in the Board of Directors and management should be prohibited, and if so to what extent should it be limited.

Here we try to answer the question of how combining positions within the Board of Directors and Management affects a bank's profitability. This combination means that a member of the Board of Directors, who takes strategically important decisions, is also responsible for their execution. On the one hand, the combination of positions helps to avoid misunderstanding tasks and reduces the need for the quality of implementation monitoring. On the other hand, combining positions results in a situation when it becomes more profitable for a director to act in accordance with the management's interests, and not that of the owners. For instance, a director that is also a manager can vote for solutions that increase his own wealth and have the authority to implement such decisions – in other words, have not only the motives, but also the tools to defend his own interests.

It should be noted that the process of electing board members in a company is influenced by internal factors (Articles of Incorporation, the experience of past years, tradition established in the company) and external factors (legislation). Therefore, the practice of choosing and appointing candidates for board positions may differ much from company to company. Usually, however, directors are appointed after the company's owners cast their votes, when the owners propose candidates to the Board. For example, in Russia, the right to nominate a candidate for a post as a board member is legislatively fixed for shareholders owning more than 2% of the company. Shareholders may propose candidates attracted from the outside, a company's employees, or set up themselves as candidates.

In order to determine the impact that combining the positions has on the bank's profitability, we estimate the effect from the presence of directors that also hold manager positions in a bank. We also assess the impact of the share of such directors in the total number of board members. We use data from the *Bankscope* database on commercial banks from 112 countries in 2010.

Revealing the effect of combining positions on the Board of Directors and bank management may be useful in making decisions about bank regulation both in the framework of the Articles of Incorporation and at the legislative level. In fact, such corporate governance aspects as the responsibilities of managers and the associated limitations, the system of director voting, and disclosure requirements regarding the board's composition may be regulated at the legislative level, the regulation differ between countries. The composition of the Board of Directors, its remuneration scheme, and the rules for the selection of directors and other characteristics of corporate governance are commonly prescribed in the Articles of Incorporation. In drawing up the Articles of Incorporation, commercial banks can focus on the recommendations for corporate governance, published by the Basel Committee on Banking Supervision. This study may contribute to these recommendations with respect to the efficiency of the positions separation.

The rest of the paper is organized as follows: Section II reviews the related literature, Section III contains a description of the sample and outlines the methodology we use. Section IV presents the results, and Section V concludes.

# Literature

The combination of key positions is studied quite extensively for non-financial companies. In analyzing the possible impact of combining the positions of CEO and Chairman of

the company's operations, in addition to agency problems, Finkelstein and Avenida (1994) consider "organizational theory", according to which it is easier for a company with a single leader to accomplish better management decisions than if the decision is to be made by a number of leaders. Using return on assets as a measure of efficiency, the authors confirm the "organizational theory" hypothesis for three industries (chemical industry, computer technology and publishing). Brickley, Coles, and Jarrell (1997) consider the decisions about whether to combine CEO and Chairman positions within a company with respect to the costs and benefits of separating the positions. In addition to agency problems, the authors examine the costs of changes in management. Such costs appear because for a new career the CEO must thoroughly comprehend the current company's strategy, the peculiarities of operating activities, and the management hierarchy. Relatively lower costs arise if the position of CEO is taken by the current Chairman of the Board of Directors, who possesses such information about the company. The authors describe a so-called "pass-the-baton" effect, which puts in doubt the results of previous studies devoted to the division of the posts. The effect implies that in companies where a combination of key leadership positions exists, during the election of a new CEO-Chairman, the old one remains as Chairman during the trial period for a newly elected head to enable the successor to settle in a new position. Formally, during this period the company has the position of CEO and Chairman of the Board of Directors separated, but immediately after the probationary period these are again combined. According to the research results, from that point of view the costs of separating the positions for the company exceed the benefits. Sundaramurthy et al (1997) scrutinize the aspects of the company's policy on the prevention of hostile takeovers. According the regression analysis results, separation of the positions of CEO and Chairman of the Board allows for a reduction of a negative reaction of the market, caused by the adoption of measures that provide protection from acquisitions, for example, via restrictions on the voting rights amendments of the Articles of Incorporation. Park and Goyal (2001) show that, for American companies, combining positions between the Chairman and CEO complicates the dismissal of an inefficient CEO. The authors conclude that the efficiency of monitoring CEO activities and control by the Board is reduced when the top positions are combined.

Braun and Sharma (2007) study the role of combining key positions in family businesses in the United States and find no significant impact on market performance indicators. At the same time, Yeh and Woidtke (2005) report a highly significant negative effect on market returns from combining positions in family businesses in Taiwan. The author reveals the same influence for non-family companies. De Maere and Jorissen (2011) investigate the characteristics of Boards of Directors for bankrupt and survived companies, where bankruptcy is considered as an extreme degree of institutional inefficiency. The authors note that bankrupt companies are often

characterized by combined CEO and Chairman positions. The authors consider the characteristics of corporate governance over the last five years prior to bankruptcy and come to the conclusion that in most bankrupt companies the posts of Board Chairman and CEO were held by the same person. Besides this, high Board-member turnover is highlighted as a factor contributing to the probability of bankruptcy. Amaral-Baptista, Klotzle and de Melo (2011) assess the impact of combining these positions on the efficiency of Brazilian companies. The positive impact of combining positions on equity return is explained by the "stewardship theory", which, in contrast to agency theory, postulates that managers do not provoke a conflict of interests with the owners because, in addition to financial interests, they strive to achieve the recognition of colleagues and competitors by means of successfully completed tasks. The fact that this result contradicts the empirical research for some companies is explained by the high ownership concentration and a significant share of family companies: Managers who own a large block of shares or who are relatives of the owners are more interested in the growth of net profit of the company. A positive impact of combining positions for emerging countries is also highlighted by Ramdani and Witteloostuijn (2010). The authors conduct an analysis of the alignment of key leadership positions in the countries of East Asia, specifically Indonesia, Malaysia, South Korea and Thailand. To distinguish the non-financial corporations of these countries, the authors divide the company into low, medium, and high yield. A significant positive impact is found for medium-yield companies.

The issue of separating the positions of CEO and Chairman of the Board of Directors in the banking industry was first considered by Pi and Timme (1992). The authors study the influence of separating the positions on the effectiveness of US banks, which is measured using return on assets and cost efficiency. The analysis shows that banks where the CEO is also the Board Chairman are less efficient than those in which these positions are not combined. The negative impact is greater for return on the assets than for cost efficiency. Daily and Dalton (1994) study the effects of two factors on efficiency: The share of independent members in the total number of directors and the combining of CEO and Board Chairman. The authors consider the independent directors as those who are neither shareholders or relatives of the banks shareholders, nor employees or relatives of employees of the bank. Moreover, directors are considered to be independent only if they were selected to the Board after the appointment of the current CEO. The authors show that bankrupt companies are characterized by a lower number of independent directors in conjunction with a CEO who also serves as the Chairman. They explain the negative impact of combining the positions of CEO and Chairman on the company's operations by agency costs: The presence of leadership positions in management provides the Chairman with more opportunities to meet personal interests.

For the sample of US banks, Cooper (2009) did not find a significant effect of combining the positions of CEO and Chairman on a bank's profitability. Griffith, Fogelberg, and Weeks (2002), as well as Belkhir (2009), on the contrary, found a negative relationship between such a combination and the market efficiency of commercial banks in the United States. Bektas and Kaymak (2009) studied the banks of Turkey and also did not confirm the significance of separating leadership positions for indicators of a bank's profitability.

In this paper we investigate a phenomena that is broader than combining only the positions of Board Chairman and CEO. We study how a bank's profitability may be affected by combining positions between the Board of Directors and management – the two governing bodies of a bank. In terms of agency problems, the threat from combining the positions of Chairman and CEO is that managers strive to pursue their own interests while also serving as a Board member. In fact, the Chairman does not make decisions alone, whereas the CEO is not the only one responsible for the quality of strategy implementation. Therefore, consideration of the compatibility between governing bodies helps to understand the possibility that a bank's activity is affected by the implementation of management's interests through seats on the Board.

## Data and Methodology

We use data from the *Bankscope* database, which contains information on different characteristics of banks from numerous countries. We analyze data on commercial banks from 112 countries for the year 2010. The banks for which there is no information on the Board of Directors were excluded from the sample. We also excluded observations with values of key financial indicators that do not correspond to common sense.

We also use a number of macroeconomic indicators that were taken from the World Bank's World Development Indicators Database. The final sample size contains 1118 observations.

We estimate the following model (OLS, errors were clustered by countries):

$$y_{ij} = \alpha + \beta\ multitasking_{ij} + \gamma\ controls_{ij} + \eta\ country_specifics_{j} + \varepsilon_{ij},$$

where $y_{ij}$ represents variables describing profitability of bank $i$ in country $j$, $multitasking_{ij}$ represents the set of variables that characterize the combination of positions between the Board of Directors and management bank $i$, $controls_{ij}$ is a vector of control

variables, $country_specifics_j$ is a vector of variables characterizing the peculiarities of different countries.

We use two indicators of bank profitability: Return on equity (ROE) and Return on assets (ROA). Return on assets characterizes the efficiency of bank managers, reflecting the volume of profit generated by the unit of assets. Return on equity shows shareholder return, reflecting the profit per unit of capital invested.

We evaluate the impact of combining managerial positions in two steps. At the first step we assess the effect of the presence of managers on the Board of directors. At the second step we estimate the impact of the share of directors who also hold managerial position in the total number of the Board members. We expect that combining these positions negatively affects a bank's profitability. This negative influence can be explained by the fact that when combining positions on the Board and in management, a director becomes interested in defending solutions that improve the welfare of managers, even if they do not correspond to shareholder interests; as a member of the Board of Directors, a manager receives a greater capacity to act in the interests of management. For example, such managers may promote ineffective projects in order to enhance their own reputation, and they may also refuse potentially profitable projects in an effort to relieve the working day or pursue financial indicators that allow them to get the highest salary bonus. Such actions may potentially lead to a decrease in net income, and hence profitability. Thus, the negative effect might be explained by agency problems within the organizational structure of a bank. A greater number of directors simultaneously holding managerial positions make the Board more interested in increasing the welfare of bank management. Most decisions of the Board are taken on the grounds of voting results, and thus a greater number of directors who also serve as managers favors the interests of management. Therefore, we expect that an increase in number of directors who hold managerial positions will result in lower profitability.

We also take into account the influence of key bank characteristics, specifically its size and the quality of its assets. Larger banks can more effectively allocate risks and during crises the government may support large banks in correspondence with the "too-big-to-fail" hypothesis. Therefore, we expect a positive influence of bank size on profitability. The natural logarithm of bank assets was used as a proxy for size (*ln_tassets*). The ratio of bank deposits to assets (*dep_tassets*) characterizes a bank's capacity to perform credit operations. The greater the volume of deposits attracted by the bank, the more opportunities the bank has for profit. Therefore, we suggest that the effect will be positive (Allen, Carletti, Marquez, 2011; Berger, Kick, Schaeck, 2012). The scale of credit activity of the bank is captured by the ratio of bank loans to total assets (*net_loans_tassets*). As a control variable, we also use the capital adequacy ratio (*total_capratio*), which is a measure of bank reliability. Financial stability increases the

profitability of the bank (the positive impact of the level of profitability is documented by Morrison and White, 2005; Allen, Carletti, and Marquez, 2011; Berger, Kick, and Schaeck, 2012). We also consider the level of bank credit risk. Although a large bank's exposure to risks may result in higher profits as it implies more opportunities to gain high returns, this may adversely affect the bank's activities, for example in crisis periods. As a measure of risk, we use the ratio of provisions on loans to gross loans (*llossres_to_grloans*). We expect the negative impact of the risk level on the bank's profitability (Hau and Thum, 2010).

The influence of combining posts on profitability may vary depending on whether a bank is listed publically. Assuming that the effects of combining managerial positions may differ for members of the Board of Directors of banks listed on the stock exchange from those for unlisted banks, we include in the model a dummy variable for banks listed on the stock exchange (*list*), as well as variable for the effects from a combination for listed banks (*list_leg_exe*). In the case of listed banks, the control by the shareholders is more intensive: shareholders may have more opportunities to defend their own interests, affecting Board members, for example, by voting during the election of members of the Board of Directors. Therefore, we assume that the combination of positions may have a less negative impact on profitability for listed banks.

To take into account cross-country differences, we include GDP per capita and the level of inflation of a country during 2010 into the model. We also introduce a dummy variable for countries where combining the Board Chairman and CEO positions is prohibited by law (*separation*). A list of countries that ban such combination by law was taken from the World Bank's *The Bank Regulation and Supervision Survey* (2010).

We also aim to determine whether there are any differences in the impact that combining positions has on bank profitability in emerging countries compared with those in developed ones. Indeed, most emerging countries are characterized by immature corporate governance systems. As suggested by Claessens and Yurtoglu (2012), the efficiency of corporate governance is usually associated with such institutional characteristics as the strength of legal rights, protection of ownership rights, the level of corruption, requirements for information disclosure, and transparency of the corporate governance system. A higher value of each indicator corresponds to a more mature system of corporate governance. Emerging economies tend to lag behind developed countries on each of these indicators (see Table 1, which compares the abovementioned indicators for some developed and emerging countries).

**Table 1. Indicators of Corporate Governance Development**

| Country | Strength of Legal Rights | Legal protection of minority shareholders | Anti-Corruption | Disclosure Requirements | Corporate Governance Opacity |
|---|---|---|---|---|---|
| *Developed Countries* | | | | | |
| Australia | 9 | 79 | 196 | 75 | 21 |
| Austria | 7 | 21 | 198 | 25 | 13 |
| Belgium | 7 | 54 | 137 | 42 | 13 |
| Canada | 6 | 65 | 205 | 92 | 20 |
| Denmark | 8.7 | 47 | 244 | 58 | 21 |
| Finland | 7 | 46 | 242 | 50 | 13 |
| France | 5.8 | 38 | 137 | 75 | 10 |
| Germany | 7.7 | 28 | 188 | 42 | 12 |
| Ireland | 8 | 79 | 160 | 67 | 16 |
| Japan | 6.8 | 48 | 119 | 75 | 10 |
| Netherlands | 6 | 21 | 215 | 50 | 18 |
| New Zealand | 10 | 95 | 235 | 67 | 16 |
| Norway | 7 | 44 | 210 | 58 | 17 |
| Spain | 6 | 37 | 119 | 50 | 6 |
| Sweden | 4.8 | 34 | 225 | 58 | 21 |
| Switzerland | 8 | 27 | 212 | 67 | 14 |
| United Kingdom | 9 | 93 | 190 | 83 | 14 |
| United States | 8 | 65 | 152 | 100 | 21 |
| *Average* | *7.3* | *51.2* | *188* | *63* | *15.3* |
| *Developing Countries* | | | | | |
| Brazil | 3 | 29 | -3 | 25 | 10 |
| Chile | 4 | 63 | 142 | 58 | 13 |
| China | 4.8 | 78 | -47 | . | 5 |
| Colombia | 5 | 58 | -26 | 42 | 5 |
| Czech Republic | 6.7 | 34 | 37 | . | 18 |
| Egypt | 3 | 49 | -46 | 50 | 4 |
| Hungary | 7 | 20 | 55 | . | 2 |
| Malaysia | 10 | 95 | 28 | 92 | 9 |
| Mexico | 5 | 18 | -28 | 58 | 6 |
| Morocco | 3 | 57 | -14 | . | 6 |
| Peru | 5.7 | 41 | -27 | 33 | 8 |
| Philippines | 3 | 24 | -56 | 83 | 9 |
| Poland | 8.2 | 30 | 36 | . | 11 |
| Russia | 3 | 48 | -92 | . | 11 |
| South Africa | 9 | 81 | 40 | 83 | 16 |
| Taiwan | . | 56 | 67 | 75 | 0 |
| Thailand | 4 | 85 | -24 | 92 | 8 |
| Turkey | 4 | 43 | -18 | 50 | 11 |
| *average* | *5.2* | *50.5* | *1.3* | *61.8* | *8.4* |

*Source: Claessens, Yurtoglu (2012), Corporate Governance in Emerging Markets: A Survey, pp. 47-48.*

In this paper we focus on a list of countries based on the S&P[4] index (*sp*). We evaluate the peculiarities of the influence that combining managerial positions has on profitability in emerging countries using the variable *sp_leg_exe*.

Table 2 demonstrates a more detailed description of the variables and descriptive statistics.

4 Brazil, Chile, China, Colombia, Czech Republic, Egypt, Hungary, India, Indonesia, Malaysia, South Africa, Mexico, Morocco, Peru, Philippines, Poland, Russia, Thailand, Turkey, Taiwan (https://www.sp-indexdata.com/idpfiles/citigroup/prc/active/factsheets/Factsheet_SP_Global_BMI.pdf)

**Table 2. Description of the variables and descriptive statistics**

| Variable | Variable description | N | Mean | S.E. | Min | Max |
|---|---|---|---|---|---|---|
| roe | ratio of net income to equity | 2156 | 0.034 | 0.668 | -23.490 | 4.686 |
| roa | ratio of net income to total assets | 2156 | 0.008 | 0.056 | -0.746 | 1.895 |
| leg_exe | =1 if a Board member also holds a managerial position | 2783 | 0.336 | 0.472 | 0 | 1 |
| sh_leg_exe | share of directors who also hold managerial position in the total number of the Board members | 2783 | 0.189 | 0.336 | 0 | 1 |
| sp_leg_exe | =sp*leg_exe; (sp=1 for emerging countries) | 2783 | 0.082 | 0.274 | 0 | 1 |
| list | =1 for listed banks | 2783 | 0.270 | 0.444 | 0 | 1 |
| list_legexe | =list*leg_exe | 2783 | 0.138 | 0.345 | 0 | 1 |
| separation | =1 for countries where the combination of the Board Chairman and CEO positions is prohibited by law | 2516 | 0.507 | 0.500 | 0 | 1 |
| ln_tassets | natural logarithm of total assets | 2156 | 14.786 | 2.233 | 7.915 | 21.705 |
| dep_tassets | ratio of bank deposits to assets | 2136 | 0.753 | 0.175 | 0.000 | 0.990 |
| total_capratio | capital adequacy ratio | 1348 | 17.013 | 8.911 | -46.470 | 78.300 |
| net_loans_tassets | ratio of bank loans to total assets | 1777 | 5.104 | 7.075 | 0 | 85.730 |
| llossres to_grloans | ratio of provisions on loans to gross loans | 2126 | 53.784 | 21.367 | 0 | 99.180 |
| gdp_percap | GDP per capita (USD) | 2731 | 26653.740 | 25102.810 | 199 | 103574.200 |
| inflation | inflation (annual. %) | 2730 | 5.007 | 5.690 | -5 | 45.943 |

The analysis is carried out for different model specifications. The modifications differ in the set of variables included in the model. All the specifications include a binary variable that characterizes the combination of positions, control variables responsible for bank size, assets quality, level of risk, volume of lending, and deposit activities, as well as country-level indicators. At the same time, the variables describing emerging-market peculiarities (*sp_leg_exe*) and the bank status on financial markets (*list, list_leg_exe)* are alternately included in the model. Different variations of the set of variables are used to ensure the robustness of the results.

# Results

## The Effect of Combining Positions

We begin the analysis by examining the impact of combining positions on profitability. In other words, the independent variable under consideration is a binary variable that equals one for banks that have managers on the Board of Directors. Our first-step estimations show that combining positions on the Board of Directors and in management negatively influences a bank's profitability both in terms of return on assets and return on equity.

The return on equity of a bank is lower in case a combination of positions takes place. The effect is of economic significance – the size of the effect is 4-7 p.p. – and is quite stable in various model specifications (see Table 3). Thus, in terms of shareholder profitability, a separation of powers between the Board of Directors and management is efficient. However, this conclusion is valid only for developed economies. For banks in emerging countries (according to the classification of S&P) there is an overlapping positive effect from the combination of positions (columns 2-4 in Table 3). The net impact in absolute terms is close to zero. Such an impact indicates that in these countries combining positions may be used if it is necessary for business processes and losses in profitability will not occur. The positive effect can be explained by the fact that for emerging countries a reduction of costs for monitoring management leads to growth in profitability for shareholders: In case of combining the posts of a director and a manager, the one who sets goals is also responsible for their implementation, and hence the combination helps to avoid misunderstandings between managers and directors and to reduce the need for the monitoring of a manager's performance. One of the possible explanations as to why this effect is observed across emerging markets is that in emerging economies corporate governance systems are at an early stage of development. Thus, lacking necessary experience, knowledge, and management practices may result in a less efficient separation of management and control. In case of an insufficient experience in the separation of powers between the Board and management, the delegation of authority may be less productive than a "do-it-yourself" strategy.

The impact of control variables does not always correspond to what is expected. As we assumed, a higher capital adequacy ratio positively affects the return on equity, while the level of risk decreases it. Note, however, that in both cases, the effects of size are much lower than the indices of corporate governance. However, the higher value of loans to assets adversely affects

the return on equity, whereas the size of the bank and its ability to attract deposits turned out to be insignificant.

**Table 3. Results: ROE and the effect of combining positions (s.e. in brackets)**

| Variables | 1 | 2 | 3 | 4 | 5 | 6 |
|---|---|---|---|---|---|---|
| leg_exe | -0.041** | -0.059*** | -0.062*** | -0.066** | -0.054** | -0.046** |
| | (0.019) | (0.022) | (0.022) | (0.026) | (0.026) | (0.019) |
| sp_leg_exe | | 0.067** | 0.063** | 0.062** | | |
| | | (0.029) | (0.029) | (0.029) | | |
| list | | | 0.027* | 0.023 | 0.023 | 0.030** |
| | | | (0.015) | (0.021) | (0.021) | (0.015) |
| list_legexe | | | | 0.009 | 0.018 | |
| | | | | (0.038) | (0.038) | |
| separation | -0.008 | -0.010 | -0.013 | -0.013 | -0.012 | -0.011 |
| | (0.019) | (0.019) | (0.018) | (0.018) | (0.018) | (0.018) |
| ln_tassets | 0.006 | 0.004 | 0.003 | 0.003 | 0.004 | 0.005 |
| | (0.005) | (0.005) | (0.005) | (0.005) | (0.005) | (0.005) |
| dep_tassets | -0.009 | -0.012 | -0.025 | -0.024 | -0.023 | -0.023 |
| | (0.072) | (0.071) | (0.073) | (0.073) | (0.074) | (0.074) |
| total_capratio | 0.002 | 0.002 | 0.002* | 0.002* | 0.002* | 0.002* |
| | (0.001) | (0.001) | (0.001) | (0.001) | (0.001) | (0.001) |
| llossres to_grloans | -0.030*** | -0.030*** | -0.030*** | -0.030*** | -0.030*** | -0.030*** |
| | (0.008) | (0.008) | (0.008) | (0.008) | (0.008) | (0.008) |
| net_loans_tassets | -0.001*** | -0.001*** | -0.001*** | -0.001*** | -0.001*** | -0.001*** |
| | (0.000) | (0.000) | (0.000) | (0.000) | (0.000) | (0.000) |
| gdp_percap | -0.000*** | -0.000*** | -0.000*** | -0.000*** | -0.000*** | -0.000*** |
| | (0.000) | (0.000) | (0.000) | (0.000) | (0.000) | (0.000) |
| Inflation | 0.007** | 0.007** | 0.007** | 0.007** | 0.007** | 0.007** |
| | (0.003) | (0.003) | (0.003) | (0.003) | (0.003) | (0.003) |
| Constant | 0.167 | 0.194 | 0.212* | 0.213* | 0.193 | 0.189 |
| | (0.120) | (0.121) | (0.123) | (0.124) | (0.125) | (0.123) |
| Number of observations | 1,118 | 1,118 | 1,118 | 1,118 | 1,118 | 1,118 |
| R-squared | 0.245 | 0.248 | 0.250 | 0.250 | 0.247 | 0.247 |
| Number of clusters | 112 | 112 | 112 | 112 | 112 | 112 |
| F | 6.173 | 5.172 | 5.316 | 5.272 | 5.948 | 6.289 |

*, **, and *** indicate significance at the 10%, 5%, and 1% levels, respectively

Banks listed on the stock exchanges were more profitable, however, the effects of differences in the principles of combining the positions are the same for them and for unlisted banks, i.e. the pressure of the market in this case does not reveal itself.

Country specific variables are significant in all model specifications. Higher GDP per capita and lower inflation reduce the profitability of the banking business, however, the value of both effects are quite low.

Next we analyze the influence of the positions combination on the return on assets. Evidence suggests that the effect is again negative, however, the size of this effect is very low and does not exceed 0.6 p.p. (see Table 4). Overlapping effect for emerging economies at this stage is not observed. Thus, as regards return on assets the positions combination is not efficient.

As for the other variables, in addition to a significant capital adequacy ratios and relation of provisions for loans, we document the negative significant impact of the ratio of deposits to assets on profitability. Thus, decrease of the deposit-credit activity results into higher return on assets.

The fact that the bank is listed on a stock exchange has the effect similar to that in case of return on equity, but this effect is quite unstable as it is significant only in half of the model specifications. The influence of a country's GDP per capita and inflation also did not change.

**Table 4. Results: ROA and the effect of combining positions (s.e. in brackets)**

| Variables | 1 | 2 | 3 | 4 | 5 | 6 |
|---|---|---|---|---|---|---|
| leg_exe | -0.003*** | -0.004*** | -0.005*** | -0.006*** | -0.006*** | -0.004*** |
| | (0.001) | (0.001) | (0.001) | (0.002) | (0.002) | (0.001) |
| sp_leg_exe | | 0.003 | 0.003 | 0.003 | | |
| | | (0.003) | (0.003) | (0.003) | | |
| List | | | 0.003** | 0.002 | 0.002 | 0.003** |
| | | | (0.001) | (0.002) | (0.002) | (0.001) |
| list_legexe | | | | 0.003 | 0.003 | |
| | | | | (0.003) | (0.003) | |
| Separation | -0.001 | -0.001 | -0.001 | -0.001 | -0.001 | -0.001 |
| | (0.002) | (0.002) | (0.002) | (0.002) | (0.002) | (0.002) |
| ln_tassets | 0.000 | -0.000 | -0.000 | -0.000 | -0.000 | -0.000 |
| | (0.000) | (0.000) | (0.000) | (0.000) | (0.000) | (0.000) |
| dep_tassets | -0.010** | -0.010** | -0.012** | -0.012** | -0.012** | -0.012** |
| | (0.005) | (0.005) | (0.005) | (0.005) | (0.005) | (0.005) |
| total_capratio | 0.000* | 0.000* | 0.000** | 0.000** | 0.000** | 0.000** |
| | (0.000) | (0.000) | (0.000) | (0.000) | (0.000) | (0.000) |
| llossres to_grloans | -0.002*** | -0.002*** | -0.002*** | -0.002*** | -0.002*** | -0.002*** |
| | (0.001) | (0.001) | (0.001) | (0.001) | (0.001) | (0.001) |
| net_loans_tassets | -0.000 | -0.000 | -0.000 | -0.000 | -0.000 | -0.000 |
| | (0.000) | (0.000) | (0.000) | (0.000) | (0.000) | (0.000) |
| gdp_percap | -0.000*** | -0.000*** | -0.000*** | -0.000*** | -0.000*** | -0.000*** |
| | (0.000) | (0.000) | (0.000) | (0.000) | (0.000) | (0.000) |
| Inflation | 0.001*** | 0.001*** | 0.001*** | 0.001*** | 0.001*** | 0.001*** |
| | (0.000) | (0.000) | (0.000) | (0.000) | (0.000) | (0.000) |
| Constant | 0.023** | 0.024** | 0.026** | 0.027** | 0.026** | 0.025** |
| | (0.011) | (0.011) | (0.011) | (0.011) | (0.012) | (0.011) |
| Number of observations | 1,118 | 1,118 | 1,118 | 1,118 | 1,118 | 1,118 |
| R-squared | 0.278 | 0.280 | 0.285 | 0.287 | 0.286 | 0.284 |
| Number of clusters | 112 | 112 | 112 | 112 | 112 | 112 |
| F | 8.787 | 8.120 | 8.424 | 7.819 | 8.229 | 8.946 |

*, **, and *** indicate significance at the 10%, 5%, and 1% levels respectively

## The Influence of the Scale of Positions Combination

At the next stage, we study the impact that the scale of combining positions and the share of board members that are also managers in the total number of board members have on the profitability of banks. Again we start with the analysis of the effects on the return on equity (see Table 5). The data show that the higher the proportion of members on the Board of Directors who combine their position with that position of manager, the lower the return on equity is. Again, the effect is economically significant, as share growth profitability decreases by 5-7 percent for every for 1 p.p. We again document the overlapping effect for emerging economies, but the net effect remains negative and accounts for 1-2 p.p. Therefore, the negative impact of combining managerial positions is softened, but does not disappear. The significance of the signs and the absolute values of other variables are preserved, which testifies to the stability of the results previously obtained.

**Table 5. Results: ROE and the effect of scale of combining positions (s.e. in brackets)**

| Variables | 1 | 2 | 3 | 4 | 5 | 6 |
|---|---|---|---|---|---|---|
| sh_leg_exe | -0.053** | -0.064*** | -0.069*** | -0.062** | -0.059* | -0.060*** |
| | (0.022) | (0.022) | (0.022) | (0.029) | (0.030) | (0.022) |
| sp_sh_leg_exe | | 0.047** | 0.042** | 0.046* | | |
| | | (0.021) | (0.021) | (0.024) | | |
| List | | | 0.026* | 0.033* | 0.030 | 0.029* |
| | | | (0.015) | (0.019) | (0.019) | (0.015) |
| list_legexe | | | | -0.015 | -0.002 | |
| | | | | (0.039) | (0.036) | |
| separation | -0.010 | -0.012 | -0.015 | -0.013 | -0.013 | -0.013 |
| | (0.019) | (0.019) | (0.018) | (0.017) | (0.017) | (0.018) |
| ln_tassets | 0.005 | 0.004 | 0.003 | 0.003 | 0.004 | 0.004 |
| | (0.004) | (0.005) | (0.005) | (0.005) | (0.005) | (0.004) |
| dep_tassets | -0.007 | -0.009 | -0.021 | -0.023 | -0.021 | -0.021 |
| | (0.071) | (0.069) | (0.071) | (0.071) | (0.072) | (0.072) |
| total_capratio | 0.002 | 0.002 | 0.002* | 0.002* | 0.002* | 0.002* |
| | (0.001) | (0.001) | (0.001) | (0.001) | (0.001) | (0.001) |
| llossres to_grloans | -0.030*** | -0.030*** | -0.030*** | -0.030*** | -0.030*** | -0.030*** |
| | (0.008) | (0.008) | (0.008) | (0.008) | (0.008) | (0.008) |
| net_loans_tassets | -0.001*** | -0.001*** | -0.001*** | -0.001*** | -0.001*** | -0.001*** |
| | (0.000) | (0.000) | (0.000) | (0.000) | (0.000) | (0.000) |
| gdp_percap | -0.000*** | -0.000*** | -0.000*** | -0.000*** | -0.000*** | -0.000*** |
| | (0.000) | (0.000) | (0.000) | (0.000) | (0.000) | (0.000) |
| Inflation | 0.008** | 0.007** | 0.007** | 0.007** | 0.007** | 0.007** |
| | (0.003) | (0.003) | (0.003) | (0.003) | (0.003) | (0.003) |
| Constant | 0.177 | 0.201* | 0.219* | 0.215* | 0.199 | 0.199 |
| | (0.119) | (0.121) | (0.123) | (0.122) | (0.122) | (0.122) |
| Number of observations | 1,118 | 1,118 | 1,118 | 1,118 | 1,118 | 1,118 |
| R-squared | 0.244 | 0.246 | 0.248 | 0.248 | 0.246 | 0.246 |
| Number of clusters | 112 | 112 | 112 | 112 | 112 | 112 |
| F | 6.547 | 5.808 | 6.068 | 5.820 | 6.546 | 6.885 |

*, **, and *** indicate significance at the 10%, 5%, and 1% levels, respectively

We also observe the negative effect from combining leadership positions within a bank for a model where the dependent variable is return on assets. The greater the share of Board member who also holds managerial positions, the lower the profitability. However, in absolute terms, the effect is much lower than for ROE (see Table 6).

The abovementioned overlapping effect for developing countries in these model specifications is absent: The variable characterizing the effect of combining emerging markets proved to be insignificant (see Table 6).

**Table 6. Results: ROA and the effect of "the scale" of combining positions (s.e. in brackets)**

| Variables | 1 | 2 | 3 | 4 | 5 | 6 |
|---|---|---|---|---|---|---|
| sh_leg_exe | -0.005*** | -0.006*** | -0.006*** | -0.007*** | -0.007*** | -0.006*** |
| | (0.002) | (0.002) | (0.002) | (0.002) | (0.002) | (0.002) |
| sp_sh_leg_exe | | 0.002 | 0.002 | 0.001 | | |
| | | (0.002) | (0.002) | (0.002) | | |
| List | | | 0.003** | 0.002 | 0.002 | 0.003** |
| | | | (0.001) | (0.002) | (0.001) | (0.001) |
| list_legexe | | | | 0.001 | 0.002 | |
| | | | | (0.002) | (0.002) | |
| Separation | -0.001 | -0.001 | -0.001 | -0.001 | -0.001 | -0.001 |
| | (0.002) | (0.002) | (0.002) | (0.002) | (0.002) | (0.002) |
| ln_tassets | 0.000 | -0.000 | -0.000 | -0.000 | -0.000 | -0.000 |
| | (0.000) | (0.000) | (0.000) | (0.000) | (0.000) | (0.000) |
| dep_tassets | -0.010** | -0.010** | -0.012** | -0.011** | -0.011** | -0.012** |
| | (0.005) | (0.005) | (0.005) | (0.005) | (0.005) | (0.005) |
| total_capratio | 0.000* | 0.000* | 0.000** | 0.000** | 0.000** | 0.000** |
| | (0.000) | (0.000) | (0.000) | (0.000) | (0.000) | (0.000) |
| llossres to_grloans | -0.002*** | -0.002*** | -0.002*** | -0.002*** | -0.002*** | -0.002*** |
| | (0.001) | (0.001) | (0.001) | (0.001) | (0.001) | (0.001) |
| net_loans_tassets | -0.000 | -0.000 | -0.000 | -0.000 | -0.000 | -0.000 |
| | (0.000) | (0.000) | (0.000) | (0.000) | (0.000) | (0.000) |
| gdp_percap | -0.000*** | -0.000*** | -0.000*** | -0.000*** | -0.000*** | -0.000*** |
| | (0.000) | (0.000) | (0.000) | (0.000) | (0.000) | (0.000) |
| Inflation | 0.001*** | 0.001*** | 0.001*** | 0.001*** | 0.001*** | 0.001*** |
| | (0.000) | (0.000) | (0.000) | (0.000) | (0.000) | (0.000) |
| Constant | 0.023** | 0.025** | 0.026** | 0.027** | 0.026** | 0.026** |
| | (0.011) | (0.011) | (0.011) | (0.011) | (0.011) | (0.011) |
| Number of observations | 1,118 | 1,118 | 1,118 | 1,118 | 1,118 | 1,118 |
| R-squared | 0.279 | 0.280 | 0.285 | 0.286 | 0.285 | 0.285 |
| Number of clusters | 112 | 112 | 112 | 112 | 112 | 112 |
| F | 9.202 | 8.538 | 8.824 | 8.135 | 8.750 | 9.492 |

*, **, and *** indicate significance at the 10%, 5%, and 1% levels, respectively

# Emerging Markets

The analysis revealed some differences in the impact that the separation of powers has on profitability among developed and emerging countries. For banks in emerging countries, we

identified an overlapping positive effect of combining positions on return on equity; total impact in absolute terms was close to zero. The overlapping effect for emerging economies was also documented while studying the impact that the scale of combining programs has on the return on equity. At this stage of analysis, the negative impact of combining managerial positions is softened, but does not disappear.

To check for the stability of these differences, we estimate the model for banks from emerging countries only. The banks of developed economies were excluded from the sample and the model was tested again.

Evidence suggests that the effect of combining positions is not significant for emerging economies (see Table 7). Such a result indicates that in these countries combining positions has no influence on business processes.

**Table 7. Results for emerging markets: ROE and the effect of combining positions**

| Variables | 1 | 2 | 3 | 4 |
|---|---|---|---|---|
| leg_exe | -0.019 | -0.013 | -0.013 | -0.016* |
| | (0.016) | (0.008) | (0.008) | (0.009) |
| list | 0.009 | | | 0.011 |
| | (0.013) | | | (0.011) |
| list_legexe | 0.004 | | | |
| | (0.028) | | | |
| separation | -0.015 | -0.013 | -0.013 | -0.015 |
| | (0.012) | (0.013) | (0.013) | (0.012) |
| ln_tassets | 0.010** | 0.010** | 0.010** | 0.010** |
| | (0.004) | (0.004) | (0.004) | (0.004) |
| dep_to_tassets | -0.028 | -0.029 | -0.029 | -0.028 |
| | (0.051) | (0.051) | (0.051) | (0.051) |
| total_capratio | -0.001 | -0.001 | -0.001 | -0.001 |
| | (0.001) | (0.001) | (0.001) | (0.001) |
| llossres to_grloans | -0.008 | -0.008 | -0.008 | -0.008 |
| | (0.005) | (0.005) | (0.005) | (0.005) |
| net_loans_tassets | -0.001 | -0.001 | -0.001 | -0.001 |
| | (0.001) | (0.001) | (0.001) | (0.001) |
| gdp_percap | -0.000 | -0.000 | -0.000 | -0.000 |
| | (0.000) | (0.000) | (0.000) | (0.000) |
| inflation | 0.001 | 0.000 | 0.000 | 0.001 |
| | (0.002) | (0.002) | (0.002) | (0.002) |
| Constant | 0.091 | 0.093 | 0.093 | 0.090 |
| | (0.096) | (0.102) | (0.102) | (0.100) |
| Number of observations | 280 | 280 | 280 | 280 |
| R-squared | 0.111 | 0.110 | 0.110 | 0.111 |
| Number of clusters | 17 | 17 | 17 | 17 |
| F | 13.75 | 10.92 | 10.92 | 11.64 |

*, **, and *** indicate significance at the 10%, 5%, and 1% levels, respectively

We then estimated the impact that the scale of combining positions has on return on equity. For two model specifications, we observe the negative effect from the combination of leadership positions on return on equity (see Table 8).

Therefore, even though a negative impact is not documented for all four specifications, we may conclude that these results are consistent with those derived from the first part of the analysis.

**Table 8. Results for emerging markets: ROE and the effect of "the scale" of combining positions**

| Variables | 1 | 2 | 3 | 4 |
|---|---|---|---|---|
| leg_exe | -0.005** | -0.003 | -0.003 | -0.004** |
| | (0.002) | (0.002) | (0.002) | (0.002) |
| list | 0.002* | | | 0.003** |
| | (0.001) | | | (0.001) |
| list_legexe | 0.001 | | | |
| | (0.002) | | | |
| separation | -0.001 | -0.001 | -0.001 | -0.001 |
| | (0.002) | (0.002) | (0.002) | (0.002) |
| ln_tassets | -0.000 | -0.000 | -0.000 | -0.000 |
| | (0.000) | (0.000) | (0.000) | (0.000) |
| dep_to_tassets | -0.021** | -0.021** | -0.021** | -0.021** |
| | (0.008) | (0.009) | (0.009) | (0.008) |
| total_capratio | 0.000 | 0.000 | 0.000 | 0.000 |
| | (0.000) | (0.000) | (0.000) | (0.000) |
| llossres to_grloans | -0.000 | -0.000 | -0.000 | -0.000 |
| | (0.000) | (0.000) | (0.000) | (0.000) |
| net_loans_tassets | -0.000 | -0.000 | -0.000 | -0.000 |
| | (0.000) | (0.000) | (0.000) | (0.000) |
| gdp_percap | -0.000 | -0.000 | -0.000 | -0.000 |
| | (0.000) | (0.000) | (0.000) | (0.000) |
| inflation | -0.000 | -0.000 | -0.000 | 0.000 |
| | (0.000) | (0.000) | (0.000) | (0.000) |
| Constant | 0.037** | 0.037** | 0.037** | 0.036** |
| | (0.015) | (0.016) | (0.016) | (0.014) |
| Number of observations | 280 | 280 | 280 | 280 |
| R-squared | 0.097 | 0.088 | 0.088 | 0.097 |
| Number of clusters | 17 | 17 | 17 | 17 |
| F | 8.330 | 13.63 | 13.63 | 8.759 |

*, **, and *** indicate significance at the 10%, 5%, and 1% levels, respectively

# Conclusion

The Basel Committee has been discussing the expediency of regulating corporate governance in the banking sector for more than 10 years already. Special attention is paid to the

issue of combining the positions of CEO and Chairman of the Board of Directors. The results of this study highlight the need for a broader approach to regulating the spheres of director responsibility, namely the need to restrict the combination not only of the Board Chairman and CEO, but also of positions between the Board of Directors and bank management.

The evidence from 112 countries show that the presence of managers in the Board of Directors has a negative impact on bank profitability, both in terms of profitability for managers (ROA) and return for shareholders (ROE). However, such a conclusion proved to be true only for developed economies. For banks in emerging countries, we identified the overlapping positive effect of combining positions. The total impact in absolute terms was close to zero, which indicates that in these countries combining positions may be used with no loss in profitability, if it is required by business processes.

We have also shown that the greater the proportion of directors that also hold managerial posts in the total number of Board members, the lower a bank's profitability is. The overlapping effect of emerging economies remained for ROE, but the net effect is negative. However, a larger number of Board members who also hold managerial positions have a negative impact on profitability to a lesser extent for banks in emerging countries than for those in developed ones.

A similar effect for emerging countries can be explained by the fact that, at this stage in emerging economies, the system of corporate governance is in the initial stages of development, including a lack of necessary experience, knowledge, and management practices, which does not allow one to effectively separate management and control. In this case, a "do-it-yourself" strategy proves to be more productive than a control delegation in terms of profit. Therefore, separating management and control does not increase profitability and, in some cases, even reduces it.

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