

# The Effect of Corporate Governance on Strategic Change in Financial Institutions: Evidence from Ghana

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## **Abstract**

The research has investigated the effect of corporate governance on strategic change in rural banks in the Eastern Region of Ghana. It was also examined the importance of governance mechanism and strategic decisions on weaknesses and threats to the banks effective operation. It has examined the understanding of ownership, board, and the top management team in strategic change on banks values. It has also revealed the relationship between strategic/policy changes and the bank performance in the community. A quantitative methodology was used for the study. The main instrument used for data collection was self-developed questionnaire. It was revealed that the importance of governance mechanism and strategic decisions on weaknesses and threats to the effective operation of the banks were 80% very important and 90% important. However, 70% of the management personnel strongly support formal policy development and implementation of the bank. The research concluded that corporate governance has an effect on strategic change on rural banking. It is recommended that strategic changes in rural banks can be implemented if the top management team and Board of Directors agreed and placed high importance on it. A good implementation of strategic change in rural banks will really improve their performance.

**Keywords:** Corporate Governance, Strategic Change, Financial Institutions, Ghana

## **1.0 Introduction**

Over the last 15 years corporate governance has become one of the most topical issues in business and finance discourses (Keasey et al. 2005). Corporate governance is associated with the defense of shareholders' interest by the use of firm governance devices (Johnson and Greening, 1999). It covers a number of issues with a shared focus on the relationship between owners, board of directors, top management teams and CEOs, as well as the remuneration of executives at different levels (Keasey et al., 2005; Monks and Minow, 2004; Tricker, 1996).

Corporate governance is the system by which business corporations are directed and controlled. The structure of corporate governance specifies the corporation between the board, managers, shareholders and other stakeholders. The structure again, spells out the rules and procedures for making decisions on corporate affairs. By doing this, it also provides the structure through which the organization objectives are set. The structures give the means of attaining those objectives and monitoring performance. Organizations are there typically to serve the interest of widely dispersed stakeholders (that is, investors, customers, government, community members, employees, suppliers, citizens). But day-to-day control is entrusted to a small group of managers who may have little direct interaction with stakeholders. The question is: How then to ensure that managers serve the interest of stakeholders, rather than their own private interest? The need for an organization to have corporate governance arrangements are an important part of the answer. These arrangements encompass the power given to management, control over management's use of power (via institutions such as board of directors), management's accountability to stakeholders and the formal and informal processes by which stakeholders influence management decisions. In the private and quasi-private sectors, the traditional governance model positions management as accountable solely to investors (shareholders). But a growing number of corporations accept that stakeholders other than shareholders are affected by corporate activity, and that the corporation must therefore be answerable to them. This idea is the foundation of corporate social responsibility, and provides the link between CSR and governance. A board of directors often plays a key role in corporate governance. It is their responsibility to endorse the organization's strategy, develop directional policy, appoint, supervise and remunerate senior executives and to ensure accountability of the organization to its owners and authorities. In Ghana, many of research on the corporate governance attempted to focus on the operation of corporate board but little has been done in the area of governance and strategic change, most commonly the board, while excluding others like ownership and top management. Especially, the notion of corporate governance as dealing with the interaction between a firm's ownership, board and top management has not been sufficiently explored in the literature. The track record of success in bringing about strategic change within organizations is poor. For strategic intent to become reality, it is necessary to change the way in which individuals within an organization behave. These often involve radical transitions within an organization that encompass strategy, structures, systems, processes and culture. Change is about changing people, not organizations. Organizations change when the managers and employees change their way of doing business. This is what board of directors is set up to look into. In this research, the aim will be on the step towards overcoming some of these shortcomings by examining how different governance structures operate and interact to promote organization's ability to change strategically.

## **2.0 Literature Review**

The environment is assumed to be objectively determined and manifested as a source of threats and opportunities (Chaffee, 1985). Immutable by managerial actions, environmental conditions are assumed to directly influence changes in the content of strategy through a deliberate analysis of strategic alternatives (Ansoff, 1965). Also assumed to be objectively determined, organizational factors associated with inaction are considered weaknesses that

inhibit changes, and factors contributing to flexibility are considered strengths that support the need for change. Governance strategic change in organization should be responsibilities of ownership, board, and the top management team. Corporate governance mechanism should ensure that, the strategic change brings corporate fairness, transparency and accountability. For Banking Institutions to ensure transparency, their annual reports should disclose true and fair accounting information prepared in accordance with applicable standards. The corporate governance must promote active cooperation between ownership, Board, and the top management team in order to change the operations strategically. Organization gives a little recognition to corporate governance mechanism as a major contributor to organizations performance. Organization should know that, strategic change in businesses promote wealth creation. The question is “is the ownership, board, and top management team ready to change strategically?” In the wake of the worldwide trend to privatize and liberalize state economic enterprises, corporate governance mechanism has come to the forefront of discussions of institutional reform. Considerable attention has been given to the role of boards in monitoring managers and in removing non-performing CEO’s and managers. Jensen (1993) voices his concern that a lack of independent leadership makes it difficult for Boards to respond to failure in top management team. Fama and Jensen (1983) also argue that concentration of strategic decision management and decision control in one individual reduces Board’s effectiveness in monitoring top management. Corporate governance generally refers to the set of mechanisms that influence decisions made by managers when there is a separation of ownership and control.

## **2.1 The Ownership**

Since the 1970s a growing literature has developed linking corporate policies and performance with governance and ownership structures. While freely studied within academic circles, these models did not gain a more widespread popularity until very recently. Corporate scandals around the world in recent years contributed to raising awareness among managers, investors and regulators, and an effort is under way in many countries to produce quantitative measures on ownership and governance, and to estimate their impact on the value and decision-making process of firms. A great deal of attention has been given to understanding how corporate governance and ownership structures affect firm performance. Corporate governance can influence a firm’s performance whenever a conflict of interest arises between management and shareholders. The concentration of ownership and the unification of ownership and management lead to managers being subjected to less pressure from outside investors and other monitors who demand accountability, transparency and strategic renewal. Ownership concentration among the top management of the firm can lead to risk aversion and lack of willingness to engage in strategic change activities such as corporate diversification, product innovation or entering new international markets (George et al., 2005; Hill and Snell, 1988; Hoskisson et al., 2000). Agency theory stresses that the extent of involvement in risky activities is likely to be influenced by the ownership and governance of the firm (Fama, 1980; Fama and Jensen, 1983; Jensen and Meekling, 1976). According to this theory, equity ownership influence manager’s risk-taking propensity, suggesting that managers become risk averse as their ownership in the firm increases.

Strategic change typically involves taking risk.

## **2.2 The Board Composition**

A corporation, whether for-profit or nonprofit, it is required to have a governing Board of Directors. A corporation can operate as a separate legal entity, much like a person in that it can own bank accounts and can enter into contracts. However, the laws governing corporations require that a corporation ultimately is accountable to its owners. That accountability is accomplished by requiring that each corporation has a Board of Directors that represents the stockholders or the public. Members of a governing Board have certain legally required duties, including duties of care, loyalty and obedience. Board operations is often refers to the activities conducted between Board members and the phrase governance is also often refers to the Board's activities to oversee the purpose, plans and policies of the overall organization. Boards of directors provide the formal link between owners and the managers responsible for the day-to-day operations of the firm. The Board has been described as the "apex of the firm's decision control system" (Fama and Jensen, 1983). Most rural banks, however, are owner-managed and owners thus have direct and detailed insights into internal processes of the firm. As a result, there is less need for the control function of the Board and many rural banks Boards exist on paper only. However, there are also examples of rural banks having active Boards with outside members, using the Boards of Directors as a means for strategy development. Outside members are more likely to view the tasks of the board as being distinctly different and complementary to that of management, which insiders may view board work as an extension of their managerial responsibilities. Outside board members are not tied to the day-to-day operations of the firm and consequently they are likely to think more freely concerning the strategic alternatives open to the firm. Their experiences from contexts other than the firm also help generate new perspectives and ideas and can increase cognitive diversity.

## **2.3 The Top Management**

Corporate governance refers to the relationship among the Board of Directors, top management, and shareholders in determining the direction and performance of the corporation (Wheelen & Hunger, 2007). The role of the Board of Directors varies a lot from a country to another, from industry to another and from company to another. Many scholars consider that the primary responsibility of the Board of Directors is to protect the shareholders' assets and ensure they receive a decent return on their investment (Kennon, 2008). In contrast to that in some European countries, the sentiment is much different. This is because; many directors there feel that it is their primary responsibility to protect the employees of a company first, the shareholders second. In these social and political climates, corporate profitability takes a back seat the needs of workers (Kennon, 2008). Agency theory suggests that top managers' inclination to change strategy is linked to the ownership structure of the firm (Bethel and Liebeskind, 1993). This is because managers' wealth increases with growth and diversification, rather than through the total equity value of the firm. In rural banking, ownership and management are often unified, potentially making such behavior less likely. Turning instead to upper echelon theory, Hambrick and Mason (1984) speculate that top management team

cognitive characteristics, such as values, norms and interests, significantly influence the way that firms process and interpret information about their markets and customers, thus impacting also their ability to recognize and pursue strategic change. The effect of top management team characteristics on strategic change is likely to be particularly strong in rural banking because small size and flexible organizational structures intensify top management team's involvement in all activities of the firm.

#### **2.4 The interaction effect of ownership and outside directors on strategic change**

There is a potentially important link between ownership structure, Board of Directors and strategic change. Fiegner (2005) found that the Board is less likely to participate in strategic decisions in where ownership and management are separated if the CEO is the majority owner.

The reason is that, the owner-manager has power to influence strategic decisions and change in other ways that forestall the participation of the Board. Interestingly, Fiegner (2005) does not find support for the suggestion that Boards' strategic participation is less likely when there is a larger group of family members of the CEO holding majority ownership. This suggests that a board with outside board members is likely to be more involved in strategic change in closely held firms with many active members of the owner-family compared to firms where there is only one owner who is also CEO. It can further be argued that in firms that are not closely held, where ownership and management are separated, one important role for Board is to safeguard shareholders' investments in the face of potential managerial opportunism, putting emphasis on monitoring and control. Outside directors are not familiar with the day-to-day operations of firms but instead dependent on information passed on to them by management. Opportunistic management can choose which information to disclose and which to contain, and whether to present accurate or biased information. As a result, outside directors tend to rely more on financial evaluations than on strategic evaluations because such information is less ambiguous and unlikely to be biased. Consequently, strategic governance is likely to be low and managers are evaluated more on financial outcomes. In closely held firms the role of the board is different, because the risk of opportunistic behavior by management is lower (or zero).

#### **2.5 The presence of outside directors has a stronger positive effect on strategic change among closely held firms.**

Formally, the board and the top management team are separate entities of an organizational structure, where the top management team and its CEO are responsible for the everyday operations of the firm. The relationship between the Board and the top management team in firms where ownership and management are separated is likely to depend on their compositions. Larger top management teams are likely to have more skills and abilities to draw upon in identifying needs and paths for strategic change. Greater size makes Boards more independent and leads to greater information processing ability which is advantageous in the complex decisions-making that strategic change entails. Similar arguments were provided for the positive effects on strategic change by the presence of outsiders on the Board of Directors. These directors increase cognitive diversity which facilitates greater changes of spotting needs

and opportunities for strategic change. However, if there are no outside directors on the Board, it may develop a myopic and narrow view of the firm, stalling strategic change. In such cases, the ability of the top management team to internally generate different viewpoints and options for change becomes increasingly important. Moreover, one of the board's key roles is to monitor and control top management, which includes giving voice in strategic decisions. The Board is more likely to be active and play this role with outside members. In this situation, the Board may constrain and limit the room for strategic change initiatives of the top management team.

## **2.6 Risk Recognition and Assessment**

An effective internal control system requires that the material risks that could adversely affect the achievement of the bank's goal are being recognized and continually assessed. This assessment should cover all risks facing the bank and the consolidated banking organization, that is, credit risk, transfer risk, market risk, interest rate risk, operational risk, and reputational risk. Internal controls may need to be revised to appropriately address any new or previously uncontrolled risks.

## **2.7 Organizations' Performance**

The principal objective of an organization is to enhance economic value for all shareholders by making the most efficient use of its resources. An organization that meets shareholders' expectations will have greater internally generated resources. This will enable the organization to be able to pay tax, train its workforce, retain its key staff and meet its social obligations.

## **2.8 Disclosure and Transparency**

OECD (1999) principles state that, the corporate governance framework should ensure that timely and accurate disclosure is made on all material matter regarding the company including, the financial situation, the performance, ownership and governance of the company. Transparency is letting the truth be available for others. This implies a passive position on the part of private organizations under consideration. Nowadays, transparency has taken a whole new meaning that is active disclosure. The concept transparency requires not only letting the truth be available by private organizations but imposes to disclose it to every stakeholder. Disclosure should be timely and adequate to enable investors, third party analyst, or rating agencies to assess the quality of corporate governance and the true financial condition of the organization.

## **3.0 Methodology**

### **3.1 Research Design**

The method used for this research was quantitative. A survey was conducted among rural banks in the Eastern Region of Ghana to assess strategic change on corporate governance. Strategic change for this research was the dependent variable, while corporate governance was the independent variable. As part of this study, strategic change can be defined as a

difference in the form, quality, or the state over time in an organization's alignment with its external environment (Van de Ven and Poole, 1995). An organization's alignment with its external environment is defined as the fundamental pattern of present and planned resources developments and environmental interactions that indicates how the organization will achieve its objectives (Hofer and Schendel, 1978). Corporate governance is defined as a new system by which business corporations are directed and controlled (OECD, 1999). Consistently Keasey et al. (1997) has defined corporate governance to include the structures, processes, cultures and systems that engender the successful operation of organizations. Data collected for the research were both primary and secondary. Primary data was collected by means of questionnaires and secondary data was collected through journal, magazine and companies website. Variable like company size, profit and company maturity were controlled.

### **3.2 Sampling Method and Data Collection**

Purposive sampling technique was used for data collection. In all, three (3) Banks were purposively sampled because they represent rural banks that have been in existence for the past 10 years, and as such have available data bank through their company website and annual report.

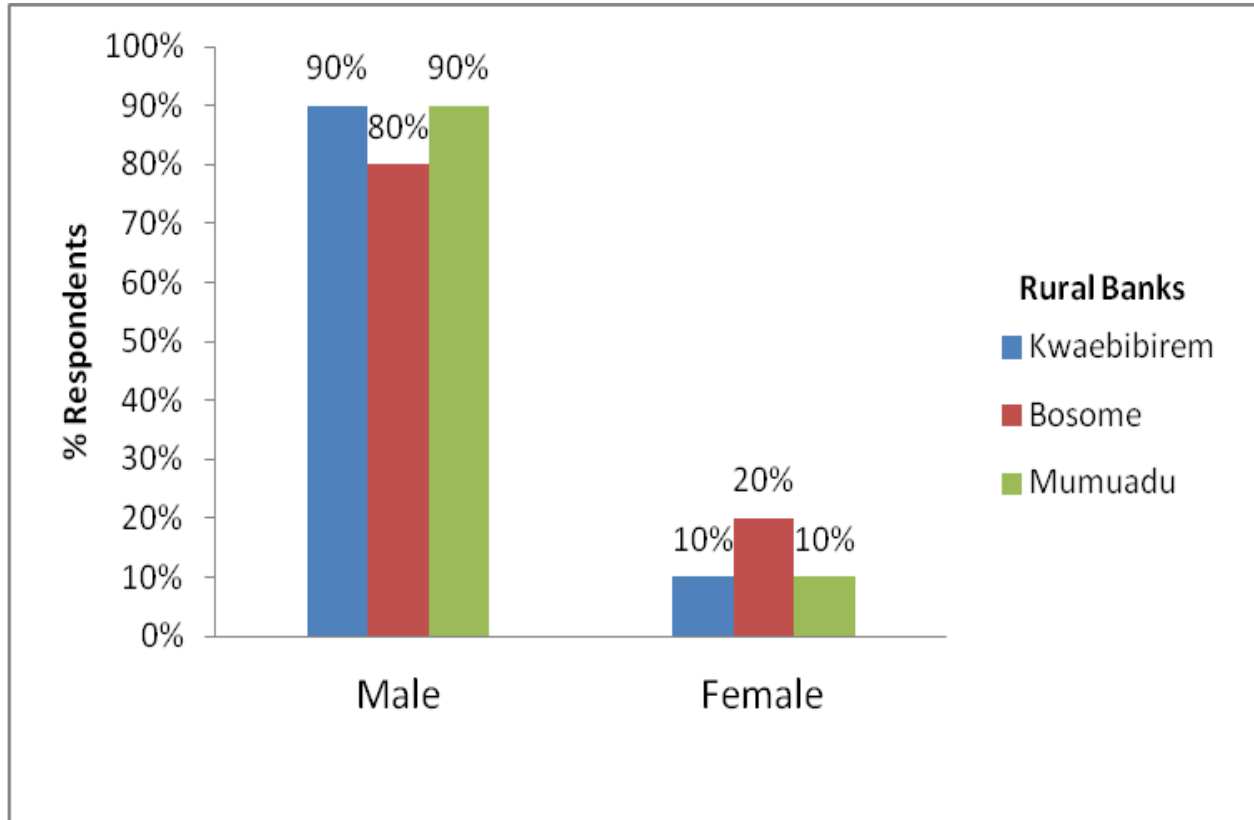
Ten (10) top management personnel from each bank were also purposively sampled from various departments. In all, one (1) top management personnel were sampled from Supervising Manager, Accountant, Project Officer, Credit Officer, Internal Auditor, IT Manager, HR Manager and two (2) others.

### **3.3 Questionnaire Design**

A 5-point likert scale was developed and used to assess view from respondents, on corporate governance on strategic change in various rural banks. In all, 30 questionnaires were administered to top management in various sections of the 3 banks (10 in each bank).The questionnaires were unstructured and closed-ended questions were used to overcome bias. The questionnaires were pre-tested for validation and reliability.

### **4.0 Empirical Results and Discussion**

The analysis deals with the responses from questionnaires distributed to the top management in 3 Rural Banks namely Kwaebibirem, Akim Bosome and Mumuadu all in the Eastern Region. Descriptive analysis in the form of frequencies and percentages were used to show results on the various variable studies in the questionnaire. Pictorial representations were also to indicate data collected.

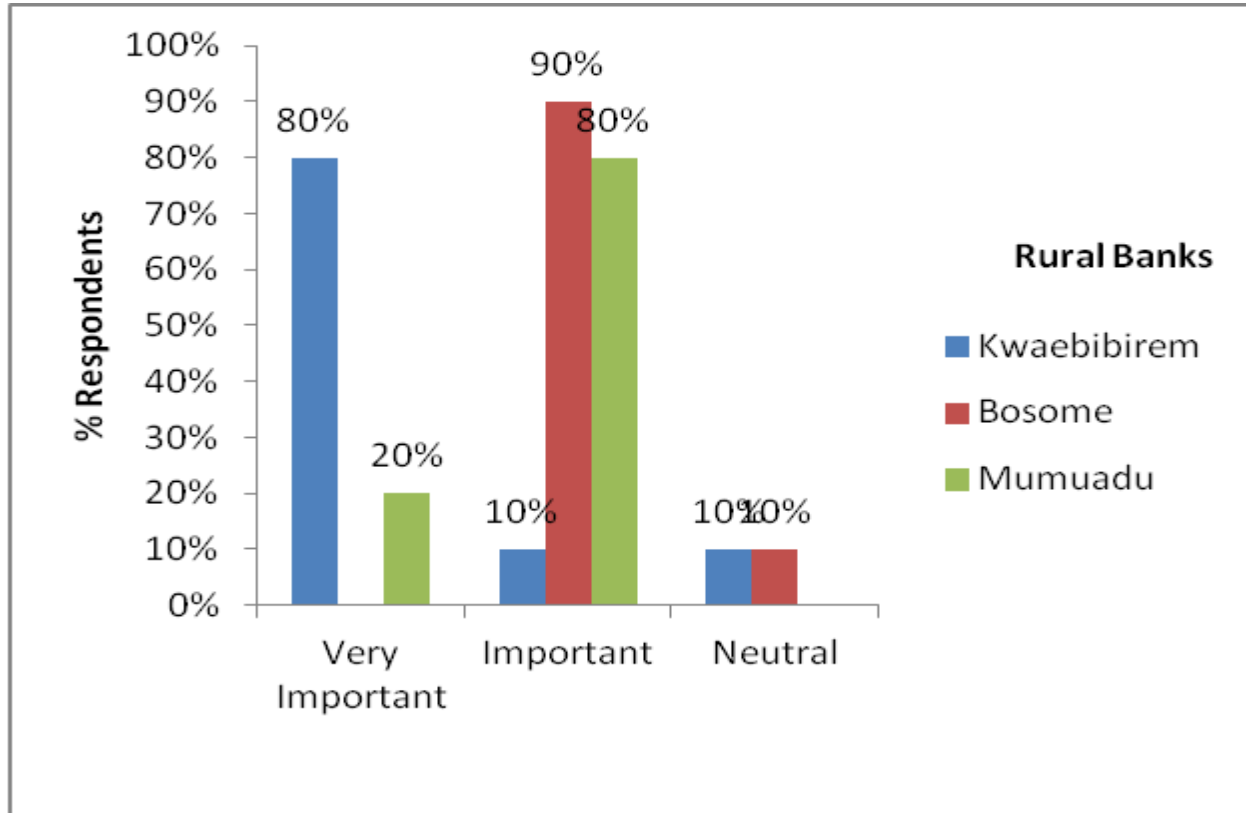


Source: Survey data, October 2011

**Figure 1: Gender relationship between the three rural banks**

Out of 30 respondents contacted at the three rural banks in the Eastern Region, male constitute 90% each from Kwaebibirem and Mumuadu Rural Banks, and 80% for Akim Bosome Rural Bank. It is also review that, female at the management level at Kwaebibirem, Akim Bosome and Mumuadu Rural Banks constitutes 10%, 20% and 10% respectively. This means that, male dominate the majority of top management level in rural banking sector.

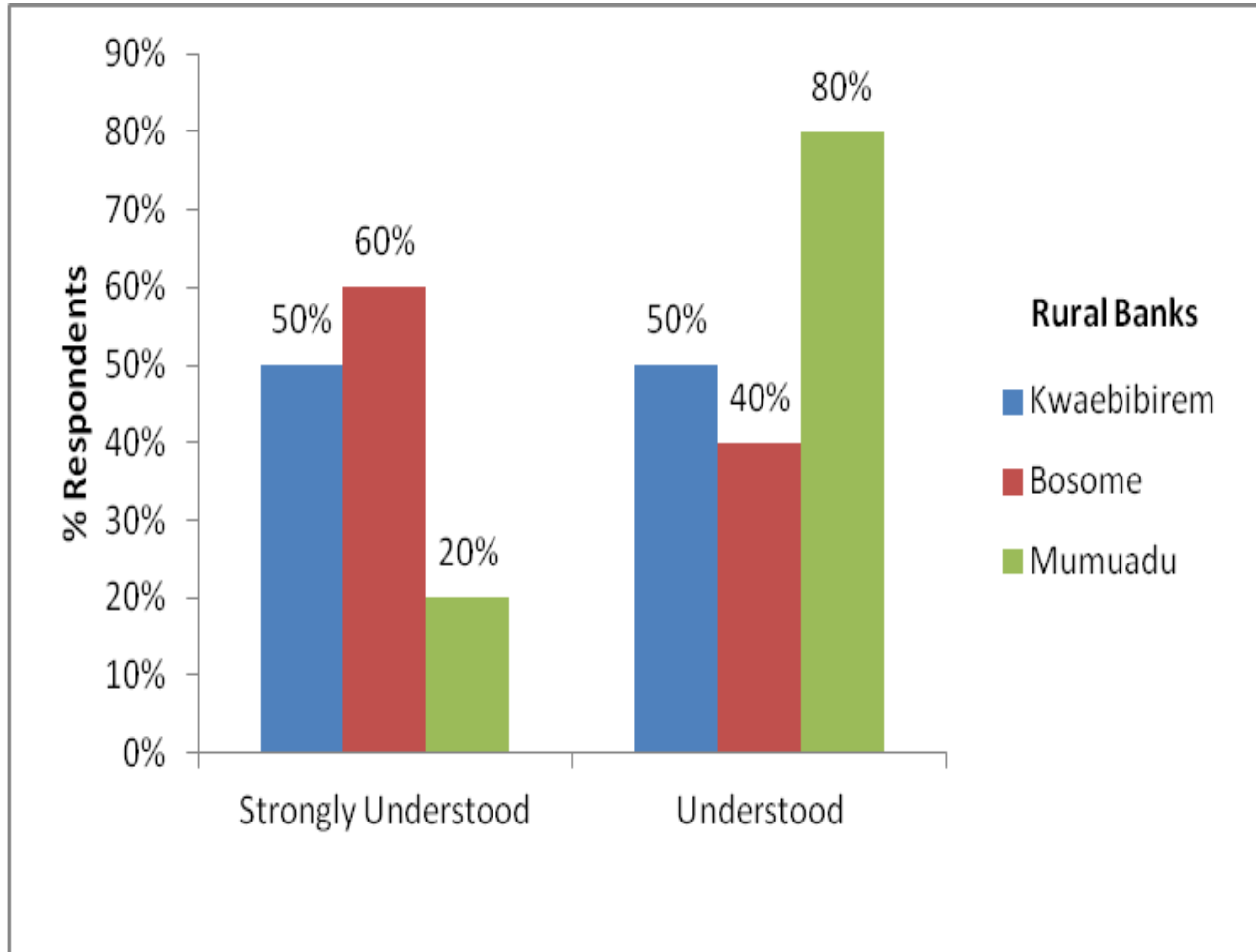




Source: Survey data, October 2011

**Figure 2 Strategic decisions towards weaknesses and threats to effective operation.**

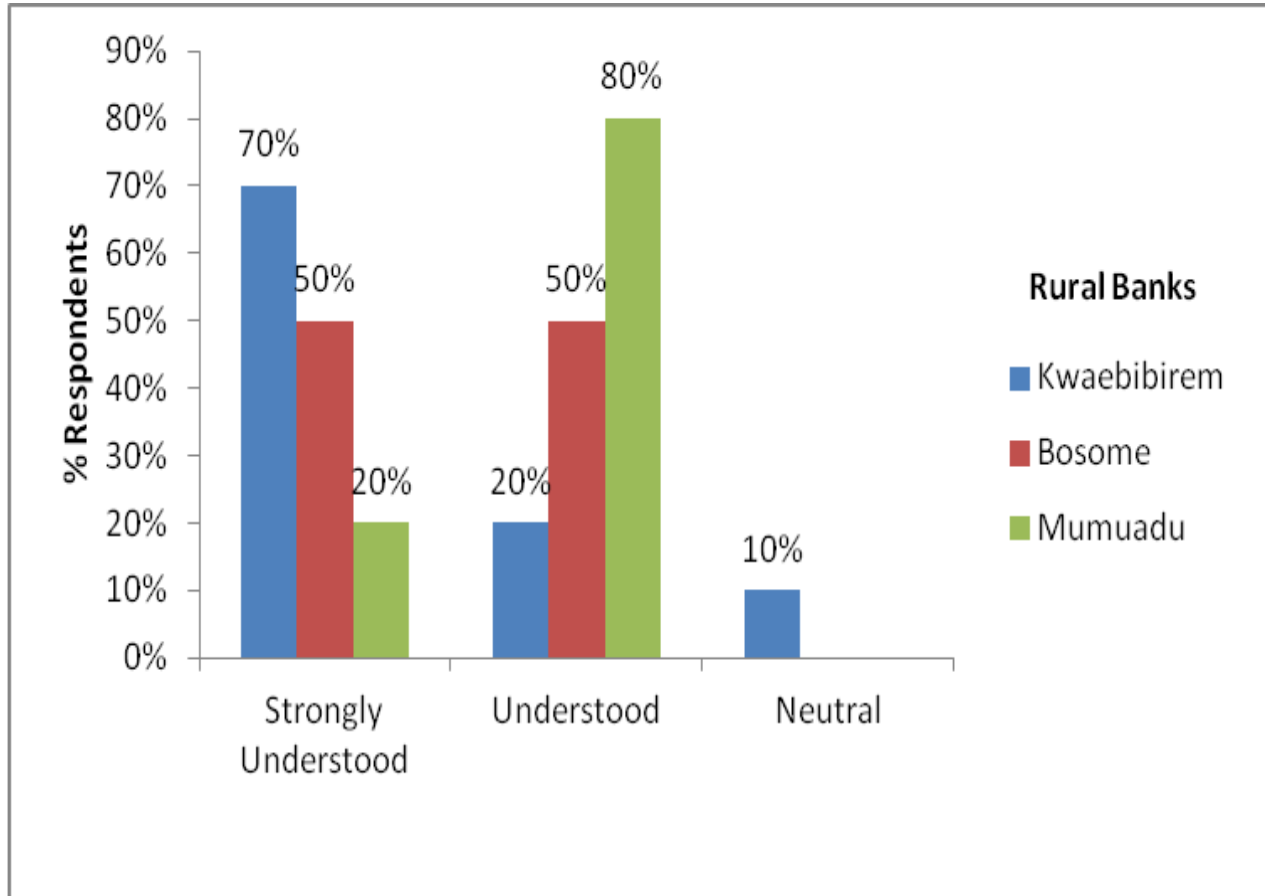
None of the respondents in Akim Bosome Rural Bank saw the strategic decision to effective operation of the bank as very important. However, 90% of the respondent accepted that strategic decisions were important and 10% were neutral to the effectiveness in the bank’s operations. 80% of the respondents from Kwaebibirem appreciated strategic decision as very important, 10% as important whiles 10% were neutral to its effectiveness in operations of the bank. Mumuadu Rural Bank recorded 20% and 80% responses as very important and important respectively.



Source: Survey data, October 2011

**Figure 3 Responses of Management understanding to Bank's value on strategic change**

Kwaebibirem, Akim Bosome and Mumuadu Rural Banks strongly understood the bank's value on strategic change in the order 30%, 60% and 20% respectively. 50%, 40% and 80% of the respondents in the Kwaebibirem, Akim Bosome and Mumuadu Rural Banks understood the bank's value on strategic change.



Source: Survey data, October 2011

**Figure 4 Board of Directors understanding of bank's value on strategic change**

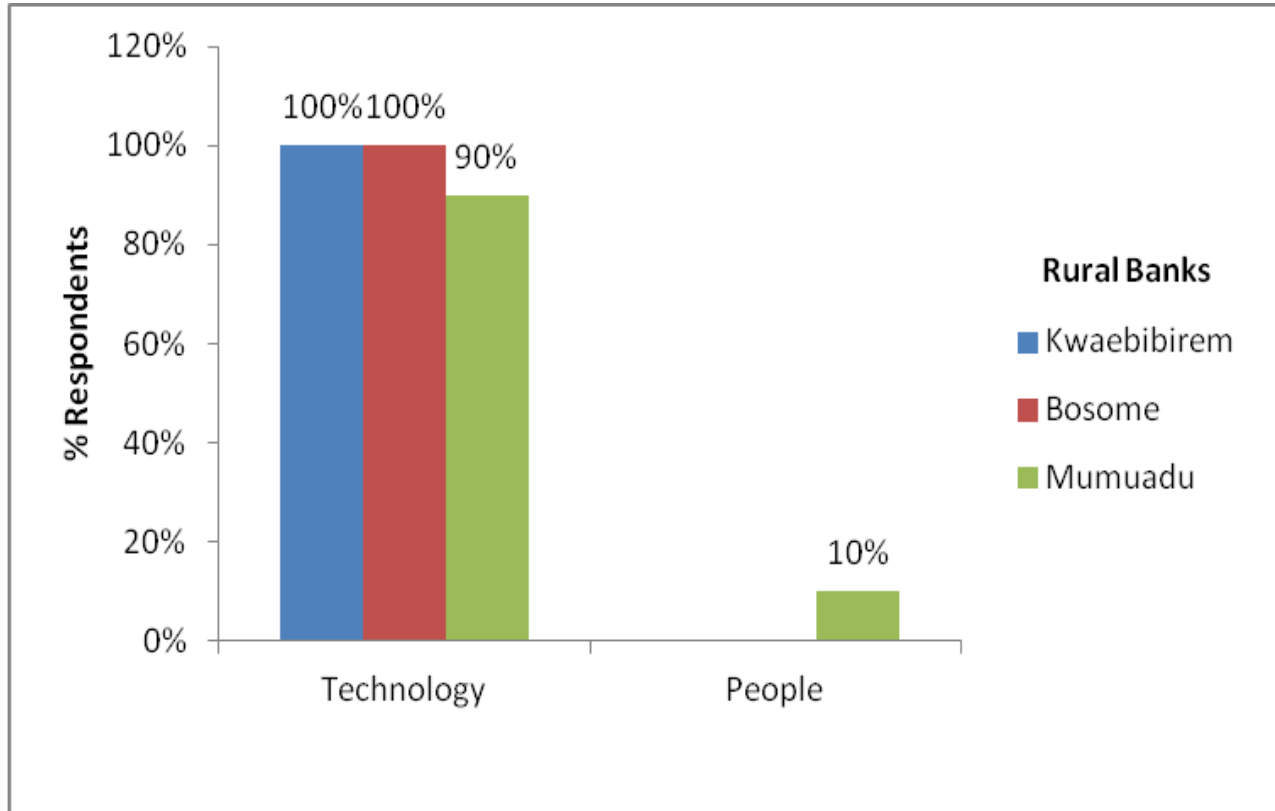
Respondents from Kwaebibirem Rural Bank showed that 10% were neutral to the bank's value on strategic change. However, 20% and 70% understood and strongly understood the concept of strategic change respectively. 50% respondents strongly understood while 50% also responded understood in Akim Bosome Rural Bank. In Mumuadu Rural Bank, 20%, and 80% responded strongly understood and understood respectively.



Source: Survey data, October 2011

**Figure 5 Banks image after strategic/policy changes**

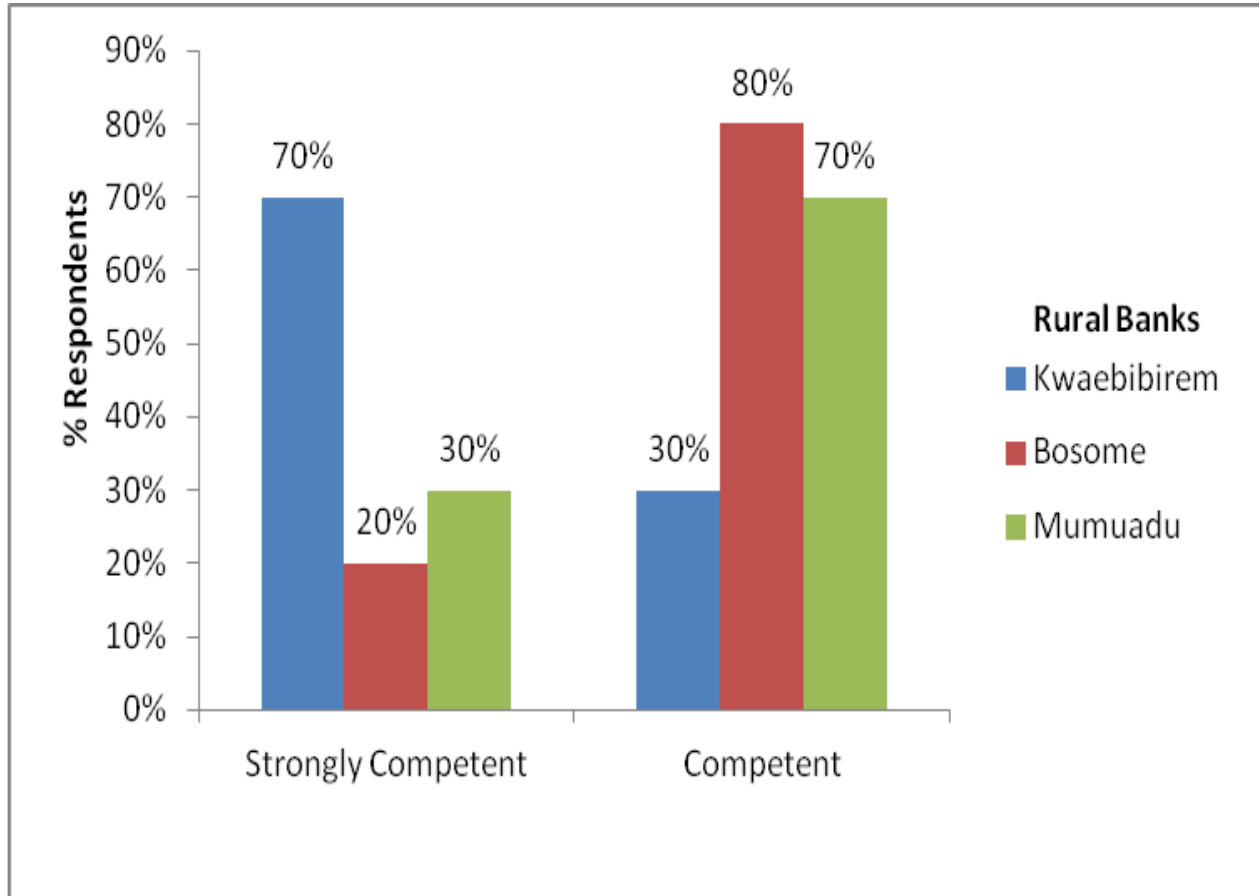
Strategic/policy changes had a positive impact on the Bank’s image. Respondents of Mumuadu Rural Bank ranked image as good (50%), and very good (50%). However, Akim Bosome Rural Bank’s image was good (20%) and very good (80%). According to respondents of Kwaebibirem Rural Bank, its image was very good (80%) and excellent (20%).



Source: Survey data, October 2011

**Figure 6 Strategic initiatives on Banks performance**

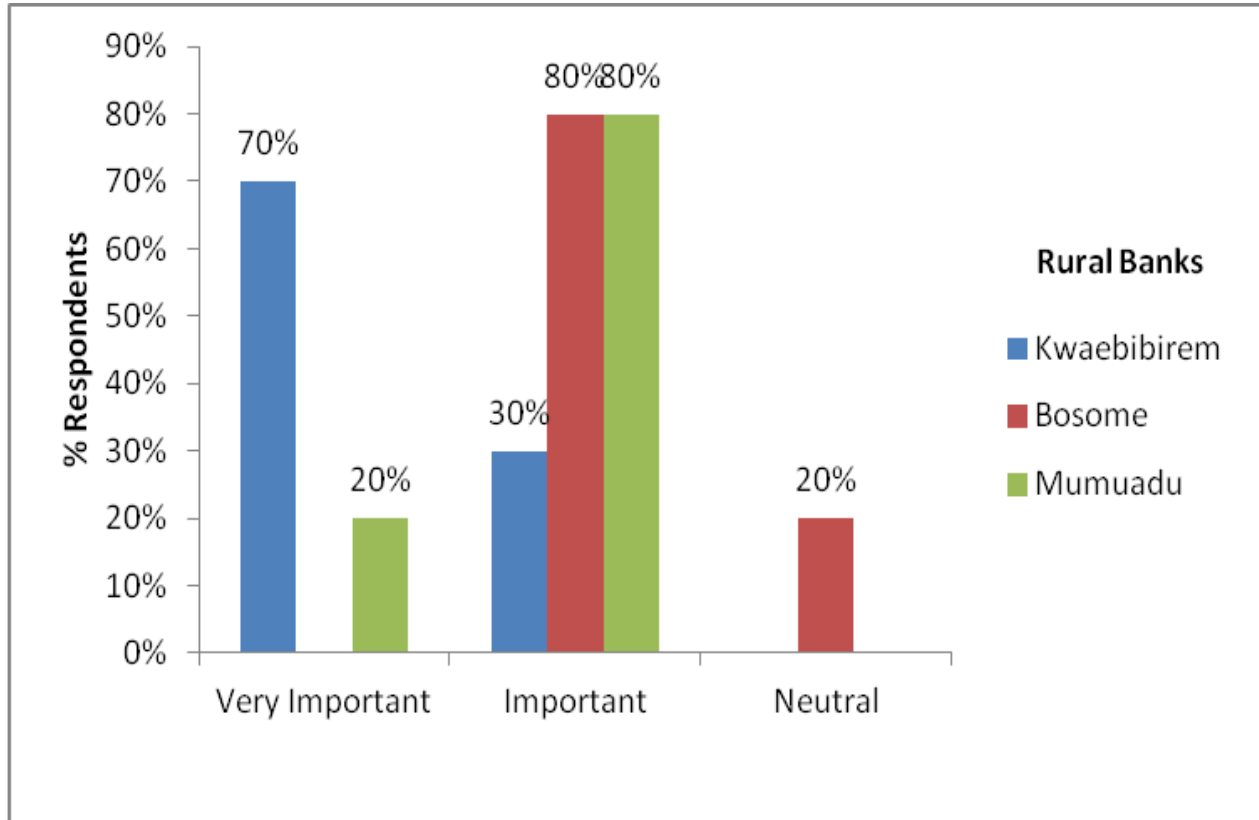
All the three Banks respondents agreed that Technology played an important role on the Banks performance. However, Mumuadu Rural Bank respondents agreed that people/HR and technology was an important factor in strategic initiative on the banks performance.



Source: Survey data, October 2011

**Figure 7 Bank’s competence in conducting SWOT analysis in strategic change**

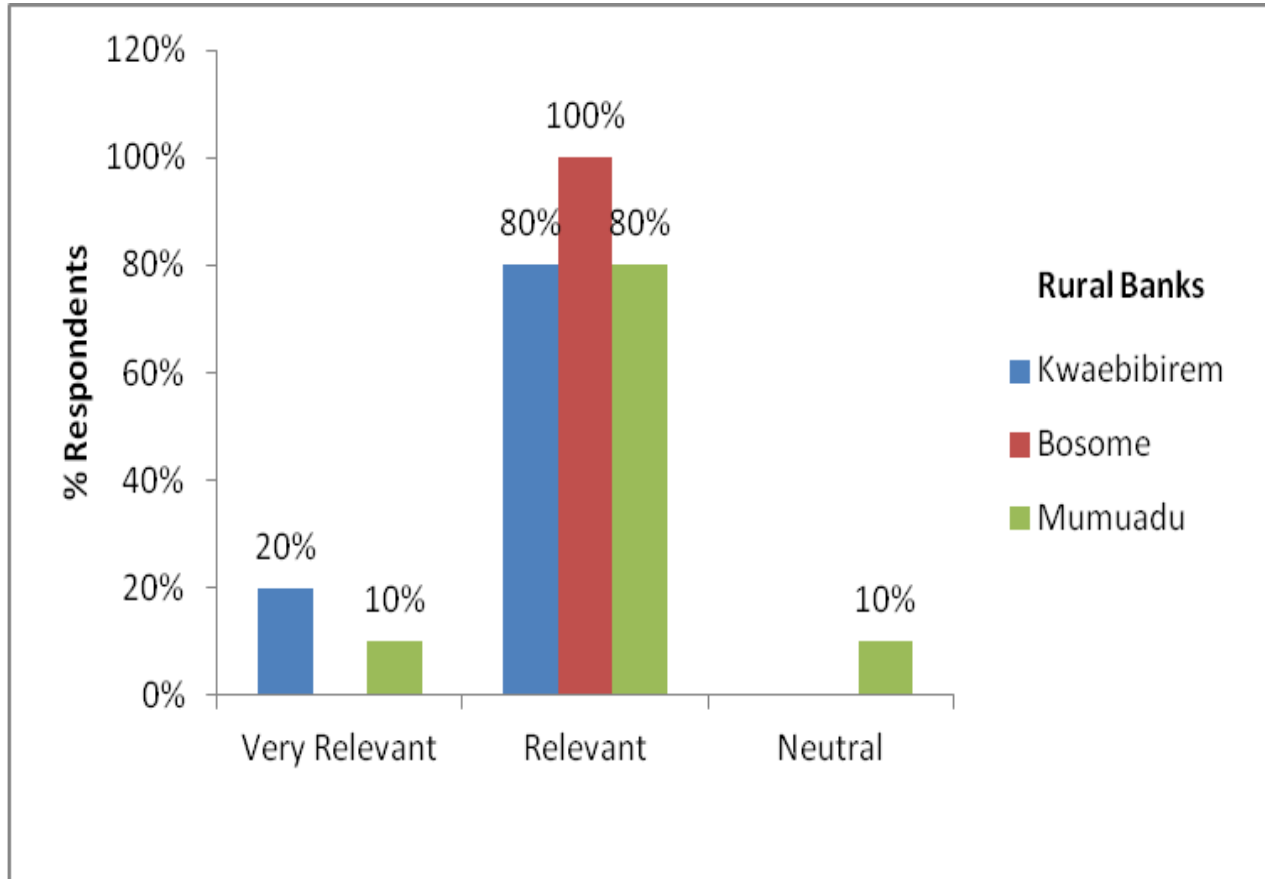
The three Banks all showed vary levels of competence in carrying out SWOT analysis. 70%, 20% and 30% of the respondents in Kwaebibirem, Akim Bosome and Mumuadu Rural Banks respectively were of the view that the banks were strongly competent in conducting SWOT analysis in strategic change. However, 30%, 80% and 70% of the respondents in Kwaebibirem, Akim Bosome and Mumuadu Rural Banks respectively agreed that the banks were competent in conducting SWOT analysis in strategic change.



Source: Survey data, October 2011

**Figure 8 Rural Banks response to SWOT analysis process in strategic change.**

A comparison of the SWOT analysis process in strategic change showed that, 70% of the respondents in Kwaebibirem Rural Bank ranked it as very important while 30% responded important. 80% respondents in Akim Bosome Rural Bank placed it as important while 20% were neutral to the SWOT analysis. However, 20% respondents very important, 80% important in Mumuadu Rural Bank.

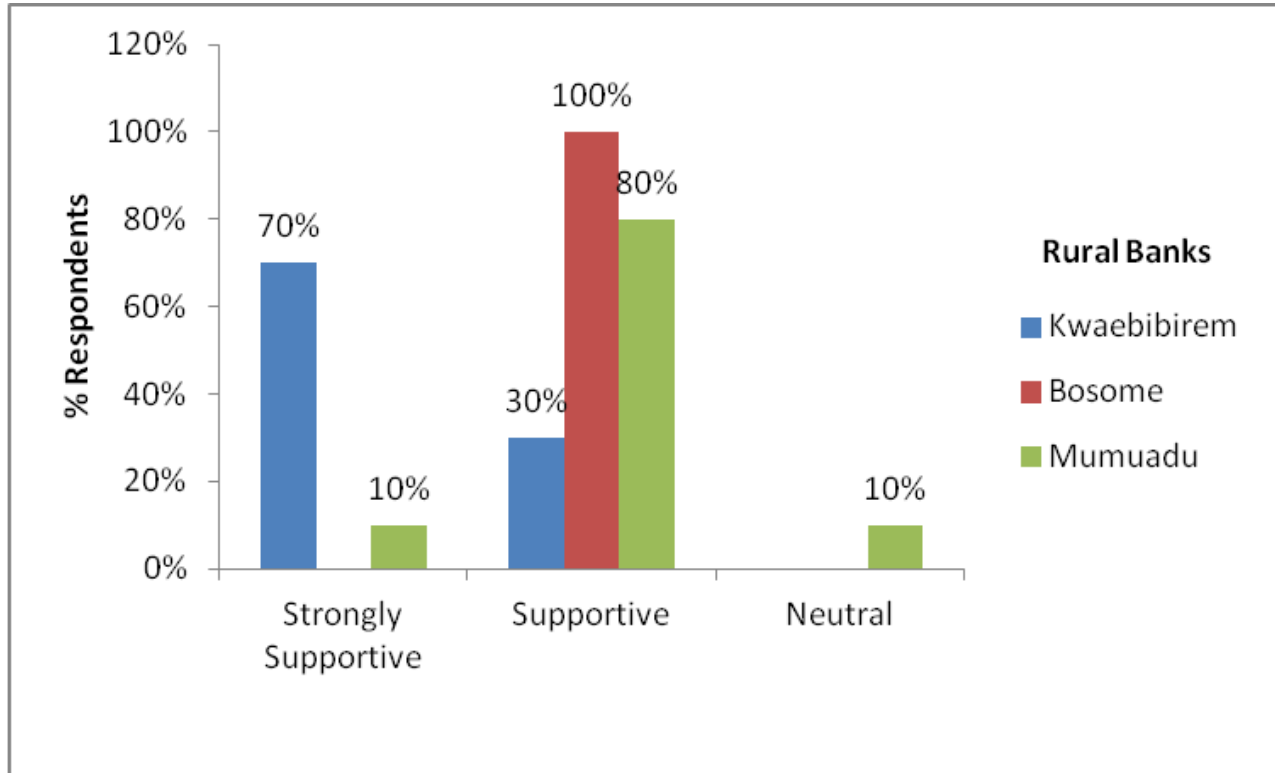


Source: Survey data, October 2011

**Figure 9 Relevance of Banks Policies to Current Activities**

A high percentage of the respondents in Mumuadu Rural Bank (80%) saw the relevance of the bank places to their current activities, while 10% of the respondent ranked as very relevant. However, 10% of the respondents were neutral to the policies of the bank in relation to their current activities. 100% of the respondents in Akim Bosome Rural Bank placed the bank policies as relevant to their current activities.

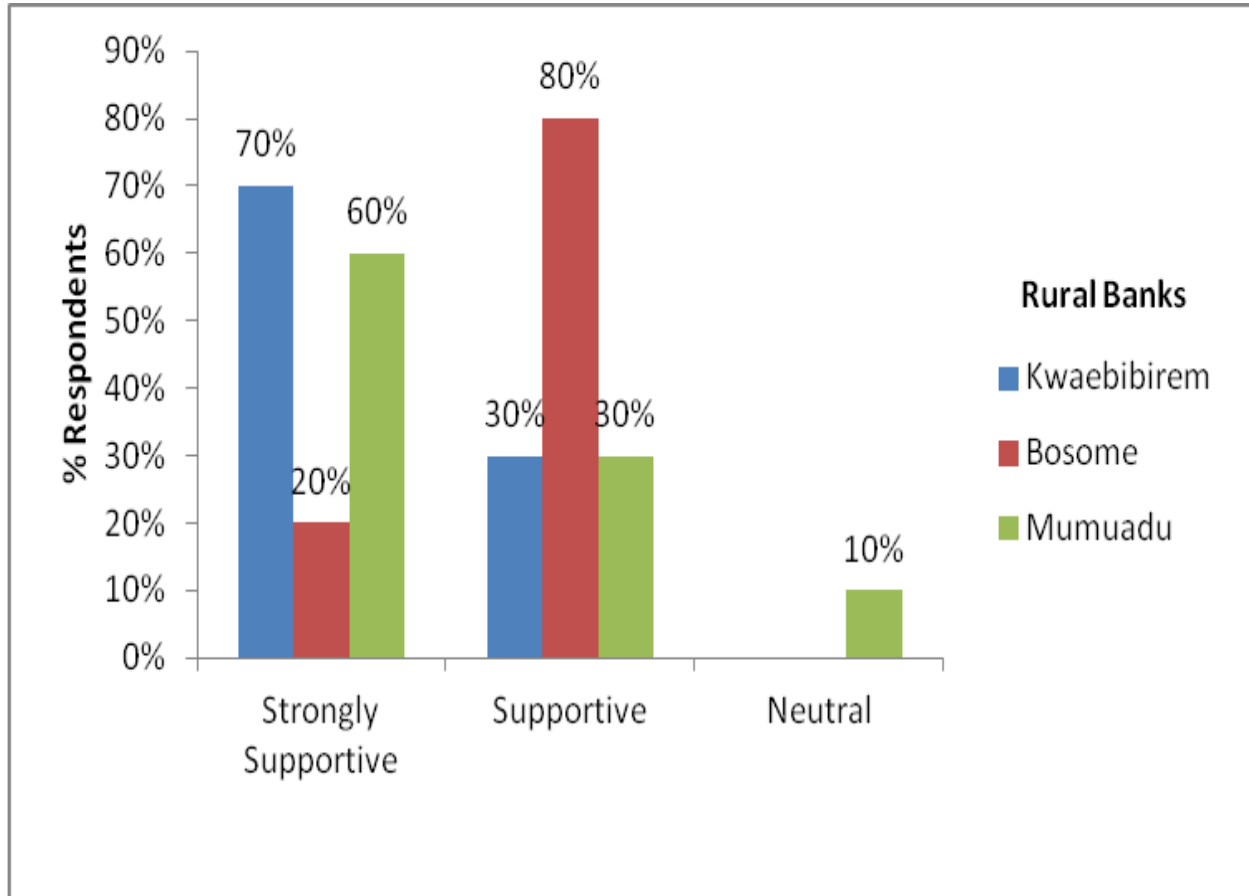




Source: Survey data, October 2011

**Figure 10 Management support for formal policy development and implementation**

Out of the three Banks in the Eastern Region visited, 10% of the respondents from Mumuadu Rural Bank were neutral to formal policy development and implementation support. Kwaebibirem, Akim Bosome and Mumuadu Rural Banks assessment show that 30%, 100% and 80% of the respondents respectively were supportive. However 70% in Kwaebibirem Rural Bank and 10% respondents in Mumuadu Rural Bank strongly supportive of formal policy development and implementation.



Source: Survey data, October 2011

**Figure 11 Board of Directors support for formal policy development and implementation**

The Board showed varying level of support to formal policy development and implementation. While 70%, 20% and 60% of the respondents in Kwaebibirem, Akim Bosom and Mumuadu Rural Banks respectively were strongly supportive, 30%, 80% and 30% of the respondents on the other hand in the Kwaebibirem, Akim Bosome and Mumuadu Rural Banks respectively were supportive. Only Mumuadu Rural Bank recorded 10% of the respondents (Board) had been neutral to formal policy development and implementation.

### 5.0 Conclusion

The study sought to ascertain the effect of corporate governance on strategic change on selected financial Institutions in the Eastern Region of Ghana. A field survey was conducted by administering unstructured questionnaire to the top management of the selected rural banks.

The results of the study revealed that majority of the top management personnel in the rural banks are male. In relation to the importance of governance mechanism and strategic decisions on weakness and threats to the effective operation of the banks, the data showed that, the

personnel of Akim Bosome and Muumuadu banks accepted that strategic decisions to effective bank operation is important at 90% and 80% respectively. On the other hand a larger number (80%) of respondents from Kwaebibirem bank indicated that strategic decisions are very important. Personnel of Kwaebibirem and Akim Bosome Rural Banks strongly understood the bank's value on strategic change at 50% and 60% respectively. However, about 80% of respondents in Mumuadu Rural Bank Limited understood the bank's value on strategic change. The management believes that, Board of Directors of all the Kwaebibirem, Akim Bosome and Mumuadu Rural Banks strongly understood the bank's values on strategic change at 70%, 50% and 80% respectively. Most of the respondents placed high relevance of their Bank policies to their current activities. It is recommended that strategic changes in rural banks can be implemented if the top management team and Board of Directors agreed and placed high importance on it. A good implementation of strategic change in rural banks will really improve their performance.

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