Governance Characteristics and Performance in European Banks: Evidence from 2013–2023 Using Panel Data

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Abstract

This paper aims to analyze the effect of governance characteristics on the performance of European banking institutions. To achieve this aim, 212 banks were examined between 2013 and 2023, using the Generalized Method of Moments (GMM) system estimation method. The results show that governance's effects on performance vary depending on the variable used to measure performance (Tobin's Q, Average Return on Assets and Average Return on Equity). Specifically, the results emphasize that performance is consistently linked to having a social responsibility committee, the size of the board, and the presence of a board governance committee. However, stakeholders have different views on whether these factors have a positive or negative impact, depending on their expectations.

The originality and key contributions of this study lie in its comprehensive integration of diverse accounting and market metrics to evaluate the performance of European banks. Additionally, the study incorporates governance variables, enhancing the academic discourse by offering novel awareness. This multi-dimensional approach not only advances theoretical understanding but also delivers practical decision-making frameworks for both internal management and external stakeholders, facilitating more informed and effective governance within financial institutions.

Keywords: Bank Profitability, Europe, GMM system

1 INTRODUCTION

Corporate governance has garnered increasing attention in the business realm in recent years, though its study dates back to the 1990s (Gibbs, 1993). Corporate governance refers to a system of practices, policies, and procedures designed to enhance decision-making efficiency, foster transparency, and economic stability, and protect the interests of shareholders and other stakeholders. Fundamentally, its core objective is to improve company performance by promoting operational efficiency and optimizing resource utilization (Galuma, 2021). Therefore, it is crucial to understand the characteristics of governance and their role in ensuring stability, integrity, and trust within the European banking system. Furthermore, it is important to examine whether governance contributes to the system's proper functioning and long-term sustainability, ultimately leading to improved performance outcomes (De Haan et al., 2016). The banking sector is key to economic growth, especially in European countries with civil law systems. This makes it important to understand what factors can boost their profitability and give them an edge over competitors (Lohano and Kashif, 2019).

At the same time, the banking sector has been encouraged to include governance frameworks in its financial practices, regulations, and policies to improve sustainability and strengthen market confidence. This approach supports long-term economic stability (Menicucci and Paolucci, 2023). In this context, studies focus on external and internal factors as the key to influencing the performance and resilience of banks (Garcia and Guerreiro, 2016; Sufian and Chong, 2008; Isayas, 2022). Although bank managers have limited control over external factors, they can improve their institution's performance by effectively managing internal variables (D'Orazio, 2023). Since the research sample is influenced by the economic conditions of the countries involved, only governance factors were considered as possible influences on banking performance. These factors relate to how institutions are managed, especially in terms of transparency, accountability, and ethics. Athar et al. (2023) used advanced methods to analyze how different aspects of governance affected the performance of 19 Pakistani banks from 2013 to 2020. Similarly, Boachie (2023) studied how governance influenced the financial performance of banks in Ghana. Recent studies, like Paolone et al. (2024), have expanded this research by combining governance and sustainability factors to better understand what drives the performance of European banks. Given the contemporary relevance and significance of

the topic, this study seeks to empirically examine the impact of governance on the performance of European banks. The analysis utilizes panel data methodology and employs the Generalized Method of Moments (GMM) system estimator, focusing on the period from 2013 to 2023.

The outcomes indicate that the impact of governance on organizational performance is contingent upon the specific metrics used to assess performance, which align with the divergent priorities of various stakeholder groups. More precisely, the evidence suggests that the implementation of a robust governance framework—encompassing sustainability practices, optimal board composition, and adherence to established governance standards—significantly influences the operational success and long-term stability of European banks. This highlights the multifaceted nature of governance, wherein distinct governance components differentially affect financial outcomes, risk management, and stakeholder satisfaction.

This research aims to make a broad contribution to both theoretical and practical domains. The findings of this study are expected to serve as a foundational reference for future investigations, prompting scholars to delve deeper into the relationship between governance characteristics and banking performance across various contexts and regions. By addressing a previously identified gap in the literature, this work seeks to expand the existing knowledge base and stimulate further academic inquiry in this area. Second, in practical terms, bank managers and executives can use this knowledge to inform their strategic decisions related to the characteristics of good governance, helping them to improve the effectiveness and profitability of their institutions. Potential investors, by understanding the relationship between *governance characteristics* and *banking performance*, can make more informed and prudent decisions about the allocation of their resources, anticipating the risk-return binomial of their portfolios. Regulators can find in this study a way to improve their supervisory practices, being able to identify areas of concern and take corrective action when necessary to protect the interests of *stakeholders* and the integrity of the banking system. Finally, an effective *governance* system in European banks can promote the stability of the financial system as a whole, protecting consumers and depositors, investors, and the wider economy from financial crises that can have devastating impacts on global society. In fact, well-governed banks are generally financially healthy with a greater capacity to finance companies and good innovation projects, which can lead to job creation and economic growth, enhancing more socioeconomic equality.

This article is organized as follows: section 2 presents the literature that supports the hypotheses raised; in section 3 the methodology that includes data and estimation method is explained. In section 4 the results are discussed in detail and finally, in the fifth section, the conclusions are presented.

2 LITERATURE REVIEW

2.1 Governance factors

2.1.1 Audit Committee

Audit committees play a crucial role in overseeing and ensuring the integrity of a company's accounting and financial practices (Ofoeda, 2017). Their ability to impartially assess financial operations and their responsibilities in identifying and mitigating risks contribute to the perception that they are reliable committees in protecting the public interest, (Ofoeda, 2017). All these actions are preventive and management strategies that aim to strengthen the financial and operational integrity of an organization, benefiting both investors and the institution itself (Hanoon et al., 2020).

In the banking sector, the strict supervision and effectiveness of the audit committee, by discouraging excessive risks, contributes to the financial stability and sustainability of banks, even if this may imply lower immediate profitability. However, in the long term, mitigating excessive risks can be seen as a strategy aimed at preserving financial health and *stakeholder* confidence, which can be crucial for the bank's long-term profitability and reputation (Sun and Liu, 2014).

Given the above, the audit committee can have a dual effect on the *performance* of organizations, and some studies point to a positive relationship (e.g., Munisi et al., 2013; Fauzi et al., 2017; Cancela et al., 2020; Neves et al., 2023) and others for a negative effect (Hassan and Hijazi 2016; Zhao et al., 2018; Puni and Anlesinya, 2020).

The study prepared by Munisi et al. (2013) for listed companies in sub-Saharan African countries shows that the audit committee positively influences the *performance* of companies. Fauzi et al. (2017), when analyzing 30 Indonesian companies listed from 2009 to 2015, also found the same results. In the same vein, Cancela et al. (2020), when considering 99 non-financial companies in the Iberian Peninsula during the period between 2013 and 2017, conclude that there is a positive relationship between the existence of the audit committee and the profitability of the asset. Neves et al. (2023), when studying Portuguese-listed companies, found this relationship for return on equity. Concerning studies that point to a negative impact, Neves et al. (2023) conclude that there is a negative relationship between this committee and the ROA. This is corroborated by

Hassan and Hijazi (2016) and Zhao et al. (2018) who conclude that there is a negative relationship between the audit committee and profitability measures – ROA and ROE. This negative effect may come from the fact that companies create this committee not because they recognize the intrinsic need for rigorous and independent supervision, but rather to meet a specific normative or regulatory requirement that entails additional costs. In the same vein, Puni and Anlesinya (2020) obtained the same results, stating that the lack of action on the part of audit committees is depriving companies of valuable resources that could significantly contribute to improving their financial health and operational effectiveness.

Finally, some studies do not find significant relationships, highlighting Cancela et al. (2020) and Neves et al. (2023) who found a non-significant relationship between the audit committee and Tobin's Q.

According to the literature, the following hypothesis is presented:

Hypothesis 1: The audit committee influences banking *performance*.

2.1.2 Board members compensation

Despite the complexity of the topic of CEO compensation (Albuquerque, et al., 2024), the literature suggests that aligning CEO compensation with the company's success is positive for value creation, according to agency theory. This alignment aims to financially incentivize managers to make decisions and actions that promote the organization's growth and sustainable performance (Chou and Buchdadi, 2018; Khatib et al., 2023).

In this sense, some studies point to a positive effect between remuneration and *performance*. For example, Müller (2014) analyzing companies listed on the London Stock Exchange during the period between 2010 and 2011 recognized that the remuneration of the chairman and non-executive directors, fees paid in shares and additional remuneration for board meetings, can significantly influence the *performance* of companies.

Handa (2018) states that the relationship between this variable and performance in financial institutions is still open to discussion, and the results are ambiguous. Nevertheless, the author suggests that, according to the agency theory, the remuneration of directors should work as an incentive, to promote greater profitability to the financial institution. In a recent article, Khan et al., (2024) show that paying a premium mitigates CEO turnover, strengthening the CEO's commitment to the organization.

Pucheta-Martínez et al. (2020), showed disparate results depending on the *performance* variable used. On the one hand, when they use Tobin's Q as a metric, they find a negative

relationship, arguing that board members may not monitor managers because they already receive high remuneration, thus diminishing their sense of responsibility. Moreover, the fact that they are well paid does not necessarily imply that they are aligned with the interests of the shareholders, as they may prioritize their own financial interests over those of the company and shareholders. On the other hand, by using ROE, the relationship is meaningful and positive, showing that by offering fair and performance-based compensation to board members, companies can foster an environment in which the interests of shareholders are prioritized, and management is oriented toward long-term success. Recently, Ferry et al., (2023) concluded that executive compensation in the short term improves the company's performance, but reduces the probability of business performance in the long term.

Additionally, Kolk and Perego (2014) conclude that there is no relationship between CEO compensation and bank profitability.

According to the literature cited, hypothesis 2 is presented:

Hypothesis 2: The board members' compensation influences banking *performance*.

2.1.3 Board Size

When it comes to the effect of the size of the board of directors on *performance*, there is also no consensus in the literature, with some authors pointing to a positive relationship (Belkhir, 2009) and others arguing that there is a negative relationship (Pathan et al., 2007). In this sense, Galal (2017) and Hakimi et al. (2018) conclude that there is a positive relationship between board size and bank profitability. Hasan et al. (2019) and Bhatia and Gulati (2021) conclude in the same sense, justifying that this positive effect is supported by the theory of resource dependence within the banking industry. With a greater number of board members, there can be greater debate over different ideas and more capacity to supervise the activities of executive managers, improving risk management and fostering profitability (Belkhir, 2009 Molla, et al., 2023). Additionally, because there are more, there can be a greater network of contacts, which allows relevant information for the business, as well as more potential for knowledge (Jackling and Johl, 2009).

According to Galal (2017), the positive relationship can be justified by the fact that the presence of more members can increase the variety of opinions and perspectives, which is crucial to deal with the risks associated with the institution's activities, which helps in making more informed decisions and thus positively influences *performance*. There is also the argument that the existence of a greater number of directors on the board makes

it possible to share and delegate responsibilities and functions among a larger group, which contributes to improving the decisions made by the board (Andoh et al., 2023).

On the other hand, Liang, et al., (2013), analyzing Chinese banks between 2003 and 2010, find a negative relationship between ROA and ROE, explaining that large boards of directors may not be as efficient, due to the challenges they face in terms of effective coordination and communication, this conclusion is corroborated by Haris et al. (2019a). In fact, a larger board of directors hinders the efficient exchange of information and ideas among members, which can lead to lower operational efficiency (Guest, 2009) and less informed decisions because they cause more noise and, consequently, a negative impact on governance and *the* institution's performance (Galal, 2017). In line with Berhe (2023), Awwad et al. (2024) and Karmani et al. (2024), also, present in their results a negative and significant relationship between the size of the board of directors and banking *performance*.

Haris et al. (2019b) concluded that there is an inverted U-shaped relationship, with a negative main directional effect, between board size and Islamic banking performance. In a recent study, Li et al., (2024) supported by the agency theory, show that larger boards of directors have a positive impact on companies' risk, and can lead to lower levels of performance.

Finally, in the literature some studies demonstrate that the relationship is not significant (Hakimi et al., 2018; Okoye et al., 2020; Talavera et al. 2018).

Following the literature exposed, the hypothesis is posed:

Hypothesis 3: The board size influences banking *performance*.

2.1.4 Social Responsibility Committee

Corporate *Social Responsibility* (*CSR)* is defined as the actions that companies decide to carry out on their own initiative and/or in compliance with legal requirements to improve social and environmental conditions, contributing to the common good (Wu and Shen, 2013). These authors also state that the decision of organizations to adopt CSR practices is not accidental, but rather a deliberate and planned choice, in the expectation of generating value in the future.

The board of directors establishes the CSR committee, thus highlighting its awareness of issues related to Social Responsibility, noting that this committee exercises a supervisory function and plays a central role in the management and promotion of transparent and accountable initiatives, while contributing positively to society and the environment (Radu and Smaili, 2021). In this context, it is assumed that the implementation of this

commission can have an impact on *the performance* of companies, however, the literature is not consensual on the *cost-benefit trade-off* of its adoption in performance levels. On the one hand, Cunha et al. (2021) conclude that the CSR committee has a positive effect on a company's performance, being optimized when the company directs its attention to employees, customers, and society in a maximum way. In addition, the authors conclude that the positive impact resulting from these determinants is conditional on the company's effectiveness in sharing transparent information about its social, environmental or ethical initiatives. In the same sense, Elmaghrabi (2021) argues that the existence of a CSR committee in a company provides greater *performance*, explained by the lower incidence of controversies since there is greater involvement of the various stakeholders and lower risk. Wu and Shen (2013) and Liu et al. (2021) also show a positive effect, justified by stakeholder theory. This theory argues that by meeting the needs of society, businesses can gain competitive advantages and strategic resources, which consequently improves their financial situation. Also Eberhardt-Toth (2017); Wasiuzzaman et al., (2022); Agnese et al., (2024) and Rashid and Kabir (2024), based on the theory of resource dependence, conclude that the existence of this commission can bring benefits to the *performance* of organizations.

On the contrary, some studies reveal a negative impact of the commission on *performance*. Chen et al. (2018), for example, show that this commission "alters the behavior of the company, generating positive externalities at the expense of shareholders." Thus, although the company is generating social and environmental benefits, this can occur by lowering shareholder returns. In fact, there may be deviations the focus of fundamental issues related to business growth and maximization of results, due to market pressure. At the same time, there can also be investment decisions that are more oriented towards the company's image than towards the generation of shareholder value, in the short and medium term (Michelon and Parbonetti, 2012; Rupley et al., 2012). In addition, the additional costs and the focus on non-financial objectives associated with social responsibility can reduce banking performance, and according to Derchi et al., (2021) the creation of this committee is a poor predictor of *performance* suggesting its symbolic role (Chams and García-Blandón, 2019).

Neves et al., (2023) present a negative and significant relationship between the CSR commission and Tobin's Q, but do not find significance between the CSR commission and the ROA and ROE. The authors justify this result by the fact that Portuguese society still does not recognize the advantages of adopting this commission since the

implementation of corporate social responsibility programs generates additional costs for the company, (investments in social, environmental and community initiatives, disclosure of sustainability reports under strict ethical and environmental standards) that reduce the results of companies and consequently profitability.

Cancela et al. (2020) do not show any significance between the CSR committee and Tobin's ROA and Q.

According to the literature cited, the hypothesis is presented as follows:

Hypothesis 4: The social responsibility committee influences banking *performance*.

2.1.5 Board Governance Committee

Corporate *governance* aims to oversee activities within a company in a way that maximizes shareholder wealth. This control can be done internally or externally, with internal control referring to "the board of directors and the board's subcommittees as monitoring bodies to oversee the behavior and actions of the company's executives" (Al Farooque et al., 2020).

The importance of board governance committees, as specialized subgroups that, for example, act in defining executive compensation, identify new potential members, supervise financial reporting, among others, has been increasing over time due to an increase in legal requirements and a much greater complexity of the environment in which companies operate (Zhu, Shen, and Hillman (2014), and Kolev, Wangrow, Barker, and Schepker, 2019).

Most listed companies have a *board governance* committee, which aims to promote accountability, improve performance and constitute a competitive advantage based on the exercise of good governance practices (Ho, 2005; Affes and Jarbouri (2023) and Edacherian, et al., 2024).

In fact, a board *governance* committee plays a crucial role in the responsible and effective management of companies and banks, ensures the good governance of institutions, enabling regulatory compliance, transparency and rigor in risk management, ethical and reliable accountability, and the protection of the interests of shareholders and other *stakeholders* (Koley, et al., 2019)

The characteristics of such a committee can vary considerably from company to company, concerning its composition (gender representativeness), responsibilities and functioning (frequency of meetings) (Henri and Héroux, 2019).

Oyerogba et al. (2017) state that the *board governance committee* performs crucial functions to ensure the effectiveness, transparency, and proper functioning of the board

and the other committees of the organization. It is relevant to highlight that all these functions are vital to promote *effective corporate governance* and ensure the sustainability and long-term value of the organization.

However, it should be noted that these committees can be flawed as being more deeply focused on specific topics, including for example the resignation of the CEO, require greater attention and discussion on controversial issues, leading to divisions that are more likely to generate conflict (Thatcher and Patel, 2012) and mortgaging the effectiveness of the committee. In fact, there is concern that overburdened managers may not effectively fulfill their fiduciary responsibilities on any board, compromising their monitoring capabilities (Fayad, et al., 2024).

Al Farooque et al. (2020) studied how boards, board subcommittees and ownership structures influence the performance of companies. Their results explain that the variables of the board structure reveal a significant explanatory power on the performance of Thai companies based on the market.

According to the literature cited, the hypothesis is presented as follows:

Hypothesis 5: The *Board Governance* Committee influences *banking* performance

2.2 Control Variables

2.2.1 Banking Efficiency

With globalization and increasing competition, companies and banks need to find new ways to reduce inefficiencies to maintain their competitiveness in the market (Keramidou, et al., 2013). Traditionally, the *cost to income ratio (CIR) (*Ben Lahoue, et al., 2023) or cost efficiency *(*Lassoued, et al., 2023) appear as measures used to measure banking efficiency

Dão (2020); Le and Nguyen (2020); Phan et al. (2020); Athari (2021), Bushashe (2023) and Citterio and King (2023), among others, support a positive relationship between the implementation of proficient cost management and bank profitability, as this is the basis for achieving a lower cost ratio and subsequently higher profitability.

Several authors indicate that a reduced CIR index reflects a more efficient use of resources, that is, they reveal the ability to use them productively and profitably to maximize profits (Oino, 2018; Neves et al., 2020; Akgün, 2021, 2024). Therefore, the higher the CIR, the more inefficient the bank, and to improve the financial performance of the institution evaluated by profitability, operational efficiency must be improved (Athanasoglou et al. 2008; Dietrich and Wanzenried 2011), i.e., costs must be reduced (Nasim, et al., 2024)

Recently, Mirzae et al. (2024), confirmed that efficiency levels have positive effects on banks' performance both during times of macroeconomic calm and in times of financial crisis. Mateev et al., (2024), also show a strong positive association between efficiency and bank profitability, showing that efficiency may also depend on the level of competition and performance of the banking market.

Although most of the literature points to a positive relationship between efficiency and bank profitability, for example, Pasiouras et al., (2009) show that macroeconomic and regulatory circumstances can lead to stricter capital requirements improving cost efficiency, but reducing profit efficiency. In highly competitive markets, operational efficiency can lead to reduced profit margins if efficiency gains are passed on to customers in the form of lower prices, rather than being maintained by the bank (Benchimol and Bozou, 2024).

Additionally, according to Khalifaturofi'ah (2023), the higher the operating costs concerning the revenue obtained, the greater the operational management problems, with negative repercussions on operating profitability.

2.2.2 Leverage

Leverage increases the potential return on capital, as banks can use the funds obtained through loans to make investments and generate additional profits, and if it is managed efficiently and the investments are made successfully, these investments can generate more results, and consequently greater *performance* (Kantharia et al., 2023).

Isayas (2022), Al-Eitan et al. (2022) and Raftis et al. (2024) showed a positive and significant relationship between the leverage ratio and banking *performance*, which means that the higher this ratio, the greater the ability of banks to generate profit.

However, this practice also increases risk, as banks are more exposed to market fluctuations and the possibility of not being able to meet their financial commitments in the event of difficulties (Ryoo, 2013).

Other authors have also found this negative relationship in the banking sector. Al-Homaidi et al. (2018) conclude that higher levels of leverage are associated with lower banking *performance* in India. This relationship is corroborated by Almaqtari et al. (2019) and Bintara (2020). The main argument is that companies incur higher expenses with the payment of interest on their debt, which decreases the profits available to owners or shareholders, conditioning their *performance*.

2.3.3 Asset quality

Asset quality is a key determinant of a financial institution's stability, growth, health, and reputation, and is a key concern for the economy as a whole (Javaid and Alalawi, 2018; Temba et al., 2024). Asset quality can be assessed by calculating the ratio of credit impairments to total loans (e.g., Jadah et al., 2020; Le Nguyen, 2020). This implies that the higher the losses on loans, the higher the ratio and the lower the quality of the assets. When there is a steady deterioration in a bank's asset quality, they become reluctant to lend again, because they face a higher risk of financial losses due to the old low-quality loans (Adelopo et al., 2018; Arrawatia et al., 2019).

Poor asset quality may expose the institution to survival risks, but on the other hand, it encourages the search for additional sources of non-interest income, in order to compensate for losses arising from non-performing loans (Ahamed, 2017). Poor asset quality may also result in reduced lending to customers. According to Nguyen (2024), the best way to avoid this reduction is through good credit risk management. To mitigate poor asset quality, managers should consider whether the market in question is more or less developed.

Bolarinwa et al. (2019), when analyzing Nigerian banks, reach the same conclusion about this negative effect for two profitability measures - ROA and ROE, highlighting that banks need to improve internal aspects, such as risk management, to achieve better *performance*.

Elekdag et al. (2020) and Horobet et al. (2021), when analysing European banks, concluded that maintaining a lower credit impairment ratio can be a promising strategy to ensure long-term profitability sustainability

At the same time, Athari et al. (2023), Nguyen (2024) also presented in their results a negative and significant relationship between this ratio and *banking performance*.

However, Saona (2016) demonstrated that there is a positive relationship between credit impairments and banking *performance*, since financial institutions in Latin America adopt higher values about the services offered by these institutions, to offset the costs associated with credit risk.

2.2.3 Size

The relationship between bank size and *performance* has shown divergent results in the literature, and there is no consensus on the subject (Gržeta, et al., 2023).

Gupta and Mahakud (2020) argue that larger banks have more advantages over smaller banks due to economies of scale and diversification, which in turn leads to higher bank profitability.

In addition, a larger bank also brings with it a greater need for visibility in terms of the market, better marketing policies and more competitive aggressiveness (Djalilov and Piesse, 2016).

The study conducted by Ding et al. (2017), which examines the profitability of banks in the United States and China during the period 2008 to 2014, concludes that between 2010 and 2014, the banking sector in the United States was able to restructure, with a positive effect of size on *performance*; however, during the crisis period (until 2010), The relationship between these two variables was negative. Almaqtari et al. (2019) and Hasanov and Al-Musehel (2018), analyzing Indian and Azerbaijani commercial banks, respectively, demonstrate that size has a positive relationship with profitability. Ali and Puah (2019) and, Caliskana and Lecunab (2020), Jadah et al. (2020) and Athari (2021) also find a positive effect, this effect suggests that larger banks obtain higher profits due to the benefits arising from loan diversification and economies of scale, while also enjoying improvements in operational efficiency and lower risk (Oino, 2018 and Martins, Serra and Stevenson, 2019). Accordingly, Awwad et al. (2024) also conclude that there is a positive relationship between size and bank profitability.

On the other hand, Knezevic and Dobromirov (2016) show a negative relationship between size and profitability, concluding that the increase in total assets does not necessarily translate into greater profitability for the financial institution. The negative effect is justified by the fact that the size of the operations is larger and with more bureaucracy, which implies an increase in the risk involved in the activities of the Batten and Vo bank (2019) justify the negative effect by the fact that there is a decrease in the quality of management and other factors that impair *banking performance*. Farooq et al. (2021) also show the same negative effect, as as banks increase in size, the effect of economies of scale may diminish or even disappear. In addition, Bortoluzzo et al. (2024) and Karmani et al. (2024) also present, in their results, a negative relationship between size and bank profitability.

2.2.4 Adequacy Capital Ratio

Assessing bank capital capacity plays a crucial role in mitigating insolvency risk (Dietrich and Wanzenried, 2011, Benchimol and Bozou 2024). This assessment is vital to ensure that banks maintain a sufficient capital buffer ensuring a sound financial buffer, thereby protecting depositors' interests against potential losses (Hersugondo, Anjani, and Pamungkas, 2021; Le at al., 2023).

Some of the theoretical studies argue that more capital leads to less need for external financing and lower cost of capital, lower cost of bankruptcy, and therefore a positive relationship between the equity ratio and bank profitability can be expected (Athanasoglou et al., 2006).

Martins, Serra and Stevenson (2019) conclude that financial institutions that have a higher level of capital demonstrate a greater availability of financial resources, which implies, in turn, an expanded capacity to deal with adversities that may arise in the financial environment (Andesen and Juelsrud, 2024).

Abbas, Iqbal and Aziz (2019), Batten and Vo (2019), Duan and Niu (2020), Le and Nguyen (2020), Saleh and Abu Afifa (2020), analyzing commercial banks, find a positive effect between capital and *performance*, highlighting the crucial importance of capital to maintain a satisfactory return. Coccorese and Girardone (2021) state that higher levels of capital are associated with safer investments, which in turn will improve the *performance* of these institutions. Additionally, Athari et al. (2023) and Raftis et al. (2024), also showed a positive and significant relationship between capital and banking *performance*.

On the other hand, higher equity capital decreases the level of financial leverage and risk, which ultimately negatively affects banking *performance* (Ali, et al., 2011; Chronopoulos, 2012).

Additionally, Bortoluzzo et al. (2024) and Karmani et al. (2024), also conclude the existence of a significant and negative relationship.

3 Research Design

3.1 Sample

All financial institutions with available data for the selected variables over the period from 2013 to 2023 were included in the analysis. The data for each variable was sourced from the Refinitiv platform and subsequently processed and visualized in a data dashboard. The final sample comprised 212 banking institutions, spanning 34 countries.

3.2 Variables

3.2.1 Dependents

The dependent variables of this study are ROAA, ROAE and QT (Mohammad, et al., 2024).

Table 1: Definition of dependent variables

Assignment	Acronym	DESCRIPTION	AUTHORS
Dependent Variables			
Average return on total assets	ROAA	$\text{ROAA} = \frac{\text{EBIT}}{\text{Total Assets}}$	Al Amosh & Khatib (2022) Athari & Bahreini (2023) Awwad & El Khoury (2024)
Average return on capital	ROAE	$\text{ROAE} = \frac{\text{Net Income}}{\text{Equity}}$	Al Amosh & Khatib (2022) Affes & Jarboui (2023) Awwad e El Khoury (2024)
Q Tobin	QT	$\frac{\text{Market capitalization} + \text{Total liabilities}}{\text{Equity} + \text{Total liabilities}}$	Al Amosh & Khatib (2022) Berhe (2023) Mateev et al. (2024)

Source: Prepared by the authors

3.2.2 Independent

Table 2 presents the variables and the expected signal for explanatory variables.

Table 2- Definition of independent variables

VARIABLES	NOTATION	DESCRIPTION	EXPECTED SIGNAL	AUTHORS
Independent Variables				
Audit Committee	ABC	A *dummy* variable that takes a value of 1 if the company has an audit committee and 0 otherwise.	+/-	Cancela et al. (2020) The Puni and Anlesinya (2020) Neves et al. (2023)
Remuneration of board members	BMC	Total remuneration of board members (ln)	+/-	Pucheta-Martínez et al. (2020) Khatib et al. (2023) Ferry et al. (2023)
Board Size	BS	Total number of board members (ln)	+/-	Bhatia A Gulati (2021) Karmani et al. (2024) Awwad et al. (2024)
Social responsibility committee	CSR	Dummy variable that takes a value of 1 if the company has a corporate social responsibility committee and 0 otherwise.	+/-	Agnese et al. (2024) Neves et al. (2023)

				Rashid Kabir (2024)
Board Governance Committee	GOV	A *dummy* variable that takes a value of 1 if the company has a government committee and 0 otherwise.	+/-	Affes and Jarbouri (2023) Fayad, et al. (2024) Edacherian, et al. (2024)
Banking Efficiency	CIR	$\frac{\text{Operational expenses}}{\text{Operating income}}$	+/-	Khalifaturofi'ah (2023) Mirzae et al. (2024) Mateev et al. (2024)
Asset Quality	LLP	$\frac{\text{Loan impairments}}{\text{Total Loans}}$	+/-	Saona (2016) Nguyen (2024)
Leverage	LEV	$\frac{\text{Total Debt}}{\text{Total Assets}}$	+/-	Bintara (2020) Isaiah (2022) Raftis et al. (2024)
Size	TA	Ln (Total Assets)	+/-	Awwad et al. (2024) Bortoluzzo et al. (2024)

				Karmani et al. (2024)
Capital Adequacy Ratio	TC	$\frac{\text{Equity}}{\text{Total Assets}}$	+/-	Raftis et al. (2024) Bortoluzzo et al. (2024) Karmani et al. (2024)

Source: Prepared by the authors

The panel data methodology was used; characterized by multiple observations collected over time for the same units of analysis, with each unit of analysis being observed in different periods (Dietrich and Wanzenried, 2011). The *GMM system*, developed by Arellano and Bover (1995), as well as by Blundell and Bond (1998), was selected for the estimation of the models due to the advantages it has compared to others. The application of this estimation method has the main advantages of solving problems of endogeneity, lag of the dependent variable and unobserved heterogeneity (Shakil et al., 2019). In addition, with panel data, we can improve the understanding of the relationships between variables, allowing a more comprehensive analysis of the interactions and effects of various variables over time. In addition, panel data enable a more comprehensive and contextualized understanding of the results under study, as they capture not only the situation at a specific moment but also the evolution and trends over time.

3.3 Models

Dynamic models are used to understand the relationship between *corporate governance variables* and the *performance* of banking institutions.

The models of this work are as follows:

$$ROAE_{it} = \beta_0 ROAE_{it-1} + \beta_1 ABC_{it} + + \beta_2 BMC_{it} + \beta_3 BS_{it} + \beta_4 CSR_{it} + \beta_5 GOV_{it} + \beta_6 CIR_{it} + \beta_8 LEV_{it} + \beta_7 LLP_{it} + \beta_9 TA_{it} + \beta_{10} TC_{it} + u_{it} + v_i \ldots\ldots\ldots (1)$$

$$ROAA_{it} = \beta_0 ROAA_{it-1} + \beta_1 ABC_{it} + + \beta_2 BMC_{it} + \beta_3 BS_{it} + \beta_4 CSR_{it} + \beta_5 GOV_{it} + \beta_6 CIR_{it} + \beta_8 LEV_{it} + \beta_7 LLP_{it} + \beta_9 TA_{it} + \beta_{10} TC_{it} + u_{it} + v_i \ldots\ldots\ldots (2)$$

$$QT_{it} = \beta_0 QT_{it-1} + \beta_1 ABC_{it} + + \beta_2 BMC_{it} + \beta_3 BS_{it} + \beta_4 CSR_{it} + \beta_5 GOV_{it} + \beta_6 CIR_{it} + \beta_8 LEV_{it} + \beta_7 LLP_{it} + \beta_9 TA_{it} + \beta_{10} TC_{it} + u_{it} + v_i \ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots (3)$$

The dependent and the independent variables are indexed by banking institution (index i) and by period (index t). The error is composed of a random component that differs according to the unit and the time, and an individual random component, specific to each company, but constant over time, $u_{it}v_i$.

4 RESULTS

4.1 Descriptive Statistics

Table 3- Descriptive Statistics of Banks

Variables	Mean	St.deviation	Min.	Max.
GAIN	0,0070286	1,0644400	-0,206767	0,2219263
LONG	0,0676474	0,1312293	-2,804231	0,4757666
QT	1,0596060	3,5629640	0,0000000	162,05580
ABC	0,2070409	0,1342964	0,0000000	0,6931472
BMC	13,731380	1,1760590	6,3563210	18,814630
BS	4,3821600	6,3762170	0,0000000	28,000000
CSR	0,4755869	0,6919080	0,0000000	1,0000000
GOV	0,5943662	0,8414833	0,0000000	1,0000000
CIR	0,0383920	0,0345140	0,1000650	0,5272994
LEV	1,5477440	1,9102720	-2,083440	13,826030
LLP	17,910970	2,8099600	9,0075180	23,337590
TA	23,067210	2,3535570	12,086430	28,644730
TC	21,480570	2,4278410	11,800090	27,082110

Source: Prepared by the authors

Table 3 presents the descriptive statistics of the variables, and it is possible to observe that all the dependent variables present a positive average. In addition, it is notable that the compensation of board members (BMC) has the highest average about *corporate governance* variables, indicating a substantial remuneration for board members.

4.2 Discussion

Table 4 presents the estimated model results.

Table 4- Estimation Results

Variables	QT				ROAA				ROAE			
	Coeff.	St. deviation	Z	p-value	Coeff.	St. deviation	Z	p-value	Coeff.	St. deviation	Z	p-value
Const	1.776	0.502	35.350	0.000***	-0.027	0.007	-3.920	0.000***	-0.539	0.070	-7.730	0.000***
ABC	-0.010	0.007	-1.390	0.164	0.010	0.001	0.190	0.846	-0.001	0.006	-0.170	0.861
BMC	0.050	0.000	0.580	0.561	0.022	0.000	0.200	0.842	0.010	0.001	-0.370	0.710
BS	0.001	0.000	6.080	0.000***	0.030	0.000	-1.530	0.126	-0.002	0.001	-3.430	0.001***
CSR	0.159	0.001	11.740	0.000***	-0.001	0.000	-4.450	0.000***	-0.006	0.003	-2.030	0.042**
GOV	-0.001	0.002	-0.270	0.791	0.001	0.000	2.930	0.003**	0.038	0.006	6.460	0.000***
CIR	-0.561	0.330	-1.700	0.090**	-0.026	0.005	-4.910	0.000***	-0.103	0.081	-1.270	0.205
LEV	0.032	0.000	0.442	0.671	0.020	0.000	3.300	0.001***	0.002	0.001	1.950	0.051*
LLP	0.002	0.000	7.530	0.000***	0.010	0.000	-3.020	0.003**	-0.002	0.001	-1.780	0.076*
TA	-0.043	0.002	-24.700	0.000***	0.001	0.000	5.210	0.000***	0.225	0.003	8.170	0.000***
TC	0.1550	0.188	8.250	0.000***	-0.004	0.002	-2.020	0.044**	-0.029	0.019	-1.490	0.136
L1	0.1330	0.012	10.780	0.000***	1.060	0.008	128.26	0.000***	1.004	0.008	125.31	0.000***
Wald			7176.9 (11)	0.000			636711.9 (11)	0.000			100865.7 (11)	0.000
m1							-2.552	0.011			-2.674	0.008
m2							0.061	0.951			-0.396	0.692

Source: Prepared by the authors

i) *, **, and *** indicate significance levels of 10%, 5%, and 1%, respectively; ii) The Wald test has a p-value of less than 5%, which means that the joint significance and coefficients are meaningfully distributed asymptotically as $\chi 2$ under a null hypothesis without significance, with the degrees of freedom in parentheses; iii) The m1 test has a normal distribution N (0.1) and tests the null hypothesis of the absence of first-order autocorrelation, against the alternative hypothesis of the existence of first-order autocorrelation; iv) The m2 test has a normal distribution N (0.1) and with a p-value greater than 5%, it accepts the null hypothesis of the absence of second-order autocorrelation.

Table 4 shows that last year's performance variables have a positive relationship with those of the current year. This suggests that stakeholders see maintaining strong performance as crucial for the European economy, which relies heavily on bank loans to finance businesses. The results highlight the usefulness of dynamic models in this study.

Regarding Board Size, the results show a positive link with market expectations (Tobin's Q), but a negative one with current shareholders' returns (ROE). A larger board may improve market valuation and governance perception, but it can also lead to inefficiencies and higher costs, reducing profitability. Increasing the number of members on the board of directors can facilitate greater discussion and the exchange of diverse ideas, leveraging a broader pool of knowledge and experience. This can lead to improved decision-making, enhanced oversight of executive management activities, and increased investor confidence (Belkhir, 2009; Molla et al., 2023). Furthermore, a larger board may provide an expanded network of contacts, which can yield valuable business insights and greater exposure to the external environment. This enhanced connectivity enables access to a variety of resources that can contribute to improved performance (Jackling and Johl, 2009). Such outcomes are consistent with the understanding that potential investors recognize future growth opportunities, and a robust network can facilitate sound long-term strategic decisions. Conversely, a larger Board of Directors may introduce a greater diversity of opinions and objectives, potentially complicating the implementation of optimal business strategies. This complexity can result in reduced operational efficiency and, consequently, a decline in profitability (Guest, 2009). This finding is consistent with the interests of current shareholders, who typically seek prompt returns; lack of consensus on strategic decisions can lead to delays in decision-making. These results support Hypothesis 3.

Regarding the impact of a social responsibility committee on banking performance, the relationship with performance variables varies based on stakeholder perceptions. From the perspective of potential investors, who prioritize long-term growth opportunities (as measured by Tobin's Q), the presence of this committee enhances the bank's reputation in the market. This, in turn, attracts socially responsible investors and supports the growth of sustainable profitability over the long term (Eberhardt-Toth, 2017; Wasiuzzaman et al., 2022; Agnese et al., 2024).

However, the additional costs and emphasis on non-financial objectives associated with social responsibility initiatives may diminish short-term profitability, as indicated by

metrics such as Return on Assets (ROA) and Return on Equity (ROE). According to Derchi et al. (2021), the establishment of such committees serves as a poor predictor of performance, suggesting a primarily symbolic role rather than one that enhances value (Chams and García-Blandón, 2019). The allocation of resources toward social responsibility activities can, in some instances, impair a bank's capacity to compete effectively in terms of pricing and operational efficiency, thereby negatively affecting financial performance indicators (Michelon and Parbonetti, 2012; Rupley et al., 2012). The positive effect of good *governance* practices on accounting/internal performance variables corroborates H5, in line with the results of Affes and Jarbouri (2023) or Edacherian, et al., (2024). Both managers and shareholders are aware of the positive impacts generated in an environment of trust not only with customers but also with employees, ensuring the operational and financial sustainability of the sector, with efficiency in the management of resources.

Regarding the existence of an audit committee and compensation for managers, there is no statistical significance in the variables, and our results do not allow us to corroborate the hypotheses posed.

For example, Kolk and Perego, (2014) also conclude that there is no relationship between CEO compensation and *performance*.

In terms of the control variables, the negative coefficient associated with the banking efficiency measure is noteworthy. This indicates that higher operating costs relative to generated revenue correlate with increased operational management challenges, adversely affecting operating profitability and Tobin's Q. Specifically, if all other factors are held constant, weaker growth prospects are perceived by potential investors (Khalifaturofi'ah, 2023). Furthermore, the findings suggest that leverage can enhance banks' Return on Assets (ROA) and Return on Equity (ROE) by enabling investment in more productive assets, thus improving financial performance (Kantharia & Biradar, 2023). However, from the market perspective, potential investors do not fully grasp this relationship. Concerning the LLP variable, the results are interesting, showing a positive effect with the market perception variable and a negative effect with the accounting/internal variables of the institutions (current managers and shareholders). In fact, from the perspective of those who manage and who receive the dividends, when a bank increases its LLPs, it is setting aside a portion of the profit to cover potential loan losses, naturally reducing the results and the available net profit, which, in turn, reduces the ROA and ROE. From the perspective of those in the market, attentive to possible

future investments, these provisions are seen as a sign of prudent management, which can increase investor confidence and the bank's market value (QT). Larger banks have the advantage of a large number of borrowers, economies of scale, and diversification, leading to low funding costs and, consequently, higher profits (Gupta and Mahakud, 2020). For this reason, managers and shareholders understand that the size of financial institutions allows them to take advantage of the efficient use of more available resources. However, a larger size also brings with it a greater need for market visibility, better marketing policies and more competitive aggressiveness, which in the view of potential investors can compromise future growth opportunities (Djalilov and Piesse, 2016). Finally, about the banks' capital ratio, our results are in line with the literature, as there is no consensus between the perspectives of those outside the bank and those who manage resources internally. Several theoretical studies suggest that higher capital levels reduce the reliance on external financing and lower the cost of capital and bankruptcy risk, indicating a positive relationship between the equity ratio and profitability (Athanasoglou et al., 2006). This perspective reflects how external observers assess banking performance (measured by Tobin's Q). Conversely, increased equity can lead to lower financial leverage and risk, which may negatively impact overall bank profitability (Ali et al., 2011; Chronopoulos, 2012). Consequently, empirical findings regarding the relationship between the equity ratio and profitability are mixed.

5 CONCLUSION

Bank profitability plays a leading role in promoting economic development, financial stability and public confidence in the banking system, especially in Europe, where the civil law system predominates.

The primary objective of this study was to analyze the effect of *governance characteristics* on the *performance* of European banking institutions, in the period between 2013 and 2023, considering the different perceptions of *stakeholders*.

Overall, the results indicate a lack of consensus among stakeholders regarding the positive or negative effects of certain governance variables on various performance measures. Specifically, the analysis from the three dynamic panel data models suggests that the social responsibility committee is often viewed as symbolic and costly, lacking short-term value. Only long-term investors recognize its potential for fostering sustainable growth. Similarly, external stakeholders value a larger board of directors for its ability to create a broader network of contacts that may improve future performance. Conversely, current shareholders perceive that an increased board size can lead to

decision-making inefficiencies, which could hinder profitability in the short term. Our findings indicate that CEO compensation and audit committee performance do not significantly explain bank performance levels. This suggests that remuneration schemes may not be effectively aligned with overall objectives, and traditional performance metrics may inadequately capture risk management and the contributions of audit committee members.

There is a shared understanding among managers and shareholders that good governance practices enhance profitability. Responsible, transparent, and ethical management is essential for achieving both operational and financial success, especially in today's environment of heightened scrutiny. Additionally, all stakeholders agree that inefficient operational management, where costs exceed revenues, results in lower performance levels. Our results also highlight that for managers and shareholders, increasing provisions may not yield immediate short-term benefits but is viewed as a strategy for improved long-term performance. In contrast, both groups appreciate the advantages of larger banks, which are expected to provide greater revenue diversification and enhanced profitability. However, potential investors express concerns that increased resources could be mismanaged in the short term, potentially exposing future returns.

Despite the main limitation of this study is the inability to obtain complete data for all variables, it can positively impact various stakeholders in the banking ecosystem:

1. **Banking Managers**: The outcomes stress the importance of adopting and promoting responsible business practices that enhance operational profitability. With improved profitability, banks can offer better working conditions and compensation in the future, thereby contributing to social welfare.
2. **Shareholders**: The study helps shareholders understand the factors that drive the value of their investments, leading to greater financial sustainability and assurance of returns.
3. **Potential Investors**: The results provide potential investors with insights that enable them to make more informed decisions about asset allocation in their portfolios, aligning with their governance expectations.
4. **Regulators**: The findings can inform the development of regulations and guidelines that foster better governance practices within the banking sector.
5. **Academics and Researchers**: This study serves as a foundation for future research, offering a benchmark for further exploration in the field.

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In future research, it would be interesting to include macroeconomic factors and compliance with sustainable development metrics, considering different institutional environments.

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