

Corporate Governance, Financial Innovation and Performance

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In recent years, the rapid development of digital technology has prompted changes in the business model of banks. The business model has shifted from conventional physical bank branches to internet banking and then to mobile banking. During 2011–2019, the banks have higher shareholding of institutional investors, ratio of independent directors, rate of directors' attendance, average education level of directors and ratio of directors with a financial or accounting background, the greater innovative financial services offered by banks. After 2015, the influence of corporate governance on banks' innovative financial services has increased. Moreover, the greater financial innovation services, the higher the bank profitability and value, especially after 2015. Finally, offering more innovative financial services can enhance the value of financial-holding subsidiary banks; by contrast, doing the same might negatively affect the profitability of nonfinancial-holding banks.

Keywords: corporate governance ; ownership structure ; board structure ; financial innovation

1. Introduction

The rapid development of financial technology is having a profound impact on the banking industry ([Cruz-García et al. 2021](#); [Hasan et al. 2020](#)), and banking services over the last decade has evolved through financial technology. Banks' performance could be improved by generating income from fees in exchange for the convenience of innovative financial services or by enhancing the value-added services to customers. Innovation-growth hypothesis posits that financial innovation reshapes the way banks provide financial services and increases diversity of banking services ([Berger 2003](#); [Merton 1992](#)). Therefore, the financial innovation enhances bank growth thanks to service improvement and diversity, risk-sharing and efficiency ([Beck et al. 2016](#); [Lee et al. 2021](#); [Cho and Chen 2021](#)). The literature has shown that banks located in countries with a higher level of financial innovation exhibit better growth of assets, loans and profits. It is important to a country to cope with financial innovation for its financial development by strengthening banks' performance and providing more diverse financial services. Overall, financial innovation is forcing the banking industry to confront changes, and it is worth studying more in-depth on whether it has impacted banks.

In recent years, Taiwan's government has promoted financial technology innovation and development. In 2015, the Establish a Digital Financial Environment 3.0 Project was implemented, and in 2016, the Financial Supervisory Commission issued the FinTech Development Strategy White Paper and proposed a vision of digital technology innovation and smart finance development. On 4 May 2017, the Regulations Governing Financial Technology Innovative Experimentation (also referred to as the Financial Regulatory Sandbox) were adopted. In September 2018, the first FinTech Space in Taiwan was established, and startups and corporate laboratories were recruited.

The rapid development of digital technology has prompted banks to adjust their conventional business model; the progression has entailed a move from conventional physical branch banking (Bank 1.0) to Internet banking (Bank 2.0), mobile banking (Bank 3.0) and, finally, to banking everywhere (Bank 4.0) ([King 2018](#)). In response to the trend of financial technology, the banking industry has sought to recruit digital finance talents, to minimize the number of bank branches and to reduce the costs of operation via adopting artificial intelligence systems. According to the statistics on the number of domestic bank branches between 2011 and 2020 published by the Financial Supervisory Commission in Taiwan, the number of domestic bank branches reached a peak of 3460 in 2014, and then gradually decreased. As of 2020, the number stood at 3403.

Studies have discovered that firms' willingness to engage in financial innovation is closely related to corporate governance. Specifically, a good corporate governance system can effectively enhance innovation performance ([Balsmeier et al. 2017](#); [Chi 2017](#); [Xiao and Zhao 2012](#)). For example, when the shareholding ratio of directors in a firm is high, the directors are aligned with firm in terms of interests, and this drives investment in financial innovation ([Chi 2017](#)).

Moreover, a higher ratio of independent directors has more influence on innovation activities ([Balsmeier et al. 2017](#)). Research has also indicated that financial innovation is positively correlated with the performance of banks ([Cheng 2018](#); [El-Chaarani and El-Abiad 2018](#); [Liu 2019](#)).

In 2015, the financial industry in Taiwan officially entered the Bank 3.0 phase. Since then, the government has promoted financial technology innovation and development in the financial industry. Therefore, 2015 is a crucial year in the development of financial innovation in the Taiwan's banking industry. The financial-holding subsidiary banks (called FHC banks) have larger market shares and abundant resources and can provide comprehensive financial services. They face greater market competition than independent banks (or called nonfinancial-holding banks, non-FHC banks), but in a more competitive market, they can readily spend resources on investment and development of financial innovation ([Huang and Chiang 2014](#)).

First, the effect of technology development on the banking industry has been widely discussed and mainly focuses on the phenomenon of the new financial industry; instead, a few studies empirically examine how the correlation between corporate governance and financial innovation impact banks' performance. Besides, this considers the effect of corporate governance of financial innovation in an emerging country, in particular, in contrast to previous studies that had focused on advanced economies. These could offer an additional insight to the existing research literature, and let government authority and financial supervisors understand the impact of corporate governance on bank financial innovation investment. Second, Taiwan's banking industry is in the early stages of financial innovation development. To analyze the effect of financial innovation on bank performance, the number of innovative financial services offered by each bank is applied as the proxy variable for measuring financial innovation.

2. History and Development

[Minetti et al. \(2015\)](#) discover that ownership structure has a negative moderation effect on a firm's innovation investment. [Choi et al. \(2012\)](#) find that ownership concentration does not have a significant effect on firms' technological innovation performance, however, some ownership types (e.g., institutional or foreign shareholders) do have a positive effect. [Ortega-Argiles et al. \(2005\)](#) state that ownership and control structures are significant for a firm's undertaking of innovation activities. [Tang and Zuo \(2014\)](#) indicate that family-owned companies are more likely to engage in innovative development. [Rong et al. \(2017\)](#) reveal that institutional investors' shareholding significantly affects a firm's investment in innovative activity, and [Xiao and Zhao \(2012\)](#) suggest that government shareholding has a negative effect on financial innovation by banks. According to [Chi \(2017\)](#), if the shareholding ratios of directors and blockholders are higher, the bank tends to exhibit higher investment in financial innovation. From agency theory perspective, shareholders from different domains have different interests in monitoring and different preferences with regard to a bank's financial innovation activities. In Taiwan, the ownership structure of banks is generally dominated by institutional holdings. The average institutional investor ownership ratio is over 65%. Moreover, since 1990, Taiwan has promoted the privatization of state-owned banks. At present, only 6 banks remain state-owned bank.

[Balsmeier et al. \(2017\)](#) demonstrate that a higher ratio of independent directors has a strong effect on a firm's innovation activities. Furthermore, independent directors have a positive moderating effect on a corporation's innovation investment ([Chen et al. 2016](#); [Lu and Wang 2018](#)). [Fu \(2019\)](#) considers that having a CEO with a shorter tenure and more independent directors can encourage a firm's innovation. According to [Gu \(2020\)](#), innovation investment is negatively correlated with board size but positively correlated with the ratio of independent directors. Independent directors play dual roles, on one hand, they safeguard the interests of shareholders based on agency theory; on the other hand, they also provide advice and resources based on resource dependence theory. Thus, they play an important role in influencing the innovative financial services offered by a bank.

[Talke et al. \(2010\)](#) contend that the diversity of the top-management team (TMT) promotes innovation activities in a firm. [Shen et al. \(2020\)](#) believe that academic experience among the TMT can promote a firm's innovation and improve its performance. Studies have also contended that the board members with technological specialties is significantly and positively correlated with innovation ([Li et al. 2019](#)) and that an authoritative board director can provide a firm with new perspectives and help promote innovative activity ([Chen and Zhao 2019](#)). Moreover, [Li \(2010\)](#) indicates that a CEO with a higher education level increases a firm's innovation intention. From resource dependence perspective, certain background characteristics of directors might influence their appetite for risk and the ability to manage financial innovation.

According to [El-Chaarani and El-Abiad \(2018\)](#), internet banking and a wide dispersion of ATMs are significantly and positively correlated with bank performance. The innovation of financial products is positively correlated with a bank's performance ([Cheng 2018](#)). In addition, the number of design and function patents held by a commercial bank is

significantly and positively correlated with its performance (Liu 2019). Chang (2017) explores whether the training of digital finance professionals has an effect on bank performance and verifies that financial innovation has a positive influence on bank performance. However, Zhao et al. (2022) find that FinTech innovation reduces banks' profitability and asset quality for large state-owned commercial banks.

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