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CEO Experience and Commercial Banks' Performance in Malaysia–Evidence from Inside, Outside and Total Working Experience

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Abstract: This paper examines the CEO experience's impact on commercial bank performance in Malaysia from 2016 to 2021. Using the fixed effect model, we find that more experienced CEOs have more incredible abilities to overcome the complexity of the banking environment, hence, improving commercial banks' performance. Specifically, the CEO, with experience working within and outside the bank (Total Working Experience), strengthens the financial performance of commercial banks. Furthermore, the CEO with working experience outside the banks has more pronounced effects in improving the banks' performance than those with experience within the banks, in which an increase of one unit of working experience enhances the bank's performance by 102% for the former and 100% for the latter. The resource dependency theory supports the findings. Based on the findings, the results suggest the importance of the CEO experience as a determinant of commercial bank performance in Malaysia. This paper provides insight into the policymakers responsible for appointing the CEOs of the banks.

Keywords: *CEO Total Working Experience, CEO Inside Working Experience, CEO Outside Working Experience, Commercial Bank, Malaysia.*

1. Introduction

A qualified CEO is key to the vitality and sustainability of an organization. Recruiting a CEO is a complex process involving the risk of appointing the wrong person or rejecting the right person. In recent years, "Does CEO matter to performance?" has become the center of attention among researchers. Though the empirical findings have proven the importance of having a skilled CEO in overcoming the challenges in a dynamic environment, the implications of an experienced CEO remain scarce from the banking industry's perspective. Therefore, this paper investigates the effect of CEO experience on commercial bank performance in Malaysia.

It is crucial to research the relationships between CEO experience and commercial bank performance in Malaysia. First, according to the Development of Financial Institutions Act of 2002 (Act 618), a CEO of a financial institution must be "fit and proper" in terms of experience and educational background to improve the bank's performance. However, according to our analysis, the Act did not specify the types of experience that a CEO should have. The Act's vagueness has incentivized us to examine further the CEO experience's impact on commercial bank performance in Malaysia. Second, the collectivist culture in Malaysia means that the banks' decision-making process will follow a group of people who work as a team (Chua et al., 2022). It signifies the importance of the top management when deciding the commercial banks' strategic actions. Nevertheless, the CEOs are the key figure who has the power to make final decisions, implying that by separating the CEO from the top management, we could examine the sole impact of an individual CEO's experience on the commercial bank's performance in Malaysia. By doing so, we could quantify the types of working experience needed for a CEO to improve commercial bank performance. Third, the banking industry faces greater challenges after the global pandemic, in which the industry must prepare for the accelerating pace of digital adoption and manage the cyber security risks within the banking environment (Raj, 2022). Amidst the challenges, a skilful leader is vital for the banking industry to remain competitive, suggesting that we must investigate the subject matter.

Using the 15 commercial banks in Malaysia from 2016 to 2021, we found that CEOs with total working experience-working within and outside the bank- tend to improve commercial bank performance in Malaysia. An increase of one year in the CEO's total working experience can increase the commercial banks' return on assets by 101 percent. Separating the CEO's total working experience into working within the banks and outside the banks has proven to us that working experience outside the banks prepared the CEO with a more remarkable ability to conquer the dynamic environment of the banking industry compared to the CEO possessing only working experience within commercial banks. Our results are supported by resource dependency (Pfeffer & Salancik, 1978), upper echelon theory (Hambrick & Mason, 1984), and stewardship theory (Donaldson & Davis, 1991). Our results are robust with fixed effect estimation corrected with robust standard error estimation due to the heteroskedasticity problem. Our paper makes several contributions to the literature. First, most of the past research, including Escriba-Esteve et al. (2009) [Spain] and Peni (2014) [Australia], was done in developed countries.

Moreover, the investigation on the relationship between CEO experience and financial performance in the Malaysian context was focused on non-financial firms (Atayal et al., 2022). Thus, we aim to investigate the role of CEO experience in the Malaysian context and in the banking industry, where the reporting requirement is different from the non-financial firms. This has not been covered much in past literature. Second, unlike Pham (2023), who studied only the CEO working experience within the banking industry, we assess the CEO experience in three dimensions – CEO total working experience, CEO working experience within the banks, and CEO working experience outside the banks, which has broadened our investigation to analyses the working experience. Third, we expect that our study can bring insight to the practitioners on the CEO hiring guidelines. Practically, the CEO shall have experience within the banking industry and outside the industry for strengthening the banking performance."

2. Literature Review

According to resource dependency theory, the CEO is the vital strategic resource for achieving the firm's goals (Pfeffer & Salancik, 1978). Experience refers to the period a CEO works throughout their lifetime in organizations to get working experience. Based on our observation, there are two competing arguments regarding the effects of CEO experience on firms' performance. In our paper, we categorize these arguments into positive and negative facets of the CEO experience.

To start with the positive aspect, researchers who find a positive impact argue that the amount of experience makes the CEOs mature and thoughtful in processing information while making strategic decisions. Hambrick & Mason (1984) asserted that CEOs with greater working experience, especially those with experience working outside the organization, have a wider perspective and more knowledge in dealing with the complexity of business operations. Peni (2014) asserts that executives with longer working years within firms have better firm-specific knowledge and contribute valuable resources. A well-experienced CEO is expected to have more forecasting power in predicting accurate earnings (Jiang et al., 2013). Escribá-Esteve et al. (2009) showed that experience links to the cognitive skills of the CEO, in which they make higher quality decisions, execute complex strategic decisions and bring higher firm value. Supported by the stewardship theory, Gupta & Mahakud (2020) and Pham (2023) found that long-serving CEOs have a greater sense of ownership, which motivates them to align their goals with the banks and foster a good relationship and work effectively with the management team; which, therefore improves performance. Khan et al. (2021) relate the CEO's experience with their ability to handle tactical decisions. Chua et al. (2022) reported that CEOs with experience working inside and outside the firm improved the firm's performance by managing firm debt. Interestingly, Zhong et al. (2023) found that CEOs with experience overcome the probability of corporate fraud. This empirical evidence supports the Upper Echelon Theory (Hambrick & Mason, 1984), which explains that experience represents the manager's skills to manage the firm's strategic actions, improving the firm performance.

On the negative impacts, Chua et al. (2022) opine on the declining ability[1] of more experienced CEOs to perform strategic actions due to the accumulative effects between the experience and the CEO's stage of life. In other words, experience and age are the events that coincide during the working life of the CEO. The older

[1] According to Inhibitory Deficit Theory (Cline & Yore, 2016), the CEO ability follows descending order when the CEO age. As experience is coinciding with CEO age, we applied the theory to explain the negative implication of CEO experience in making risky strategies.

CEO is argued to have a lower tolerance towards risky activities (Cline & Yore, 2016), which translates to lower firm performance. Nguyen et al. (2018) found an inverse relationship between CEO experience and the firms' performance in Australia. This could be due to the higher agency costs (Chua et al., 2022) and operational costs (Erickson et al., 2015) of the firms when they are led by more experienced CEOs. Firms with experienced CEOs are likely to suffer from more severe agency conflict because they have better communication skills and can suppress the pressure from internal monitoring systems. Higher operational costs are also expected from hiring experienced CEOs, as they require higher compensation and rewards, which reduces the firms' performance. Hamori & Koyuncu (2014) found that a CEO with prior experience is less able to promote post-succession firm financial performance. Likewise, Liu & Jiang (2020) inferred a negative relationship between the CEO's working experience within the firm and the firm's market value in China.

In sum, the CEO's experience appears to determine the firm's performance. We also observed that most of the studies focus on non-financial firms, and there are limited studies on the banking industry. Nevertheless, the literature shows an increasing investigation of the financial sector. For example, Gupta & Mahakud (2020) studied the CEO characteristics and bank performance in India, Khan et al. (2021) explored the effect of CEO on bank efficiency in Pakistan and Pham (2023) investigated the banking industry in Vietnam. As the literature portrays, we believe that a CEO with more experience can add value to the banking industry in Malaysia. Hence, we postulated the following hypothesis. Ha: The CEO experience has a positive relationship with commercial banks' performance in Malaysia.

3. Methodology

Sample: The study examines the relationship between CEO experience and commercial bank performance. In this study, all the financial data were collected from Thomson Reuters, whereas all the CEO features, such as experience and education, were extracted from the banks' annual financial performance. We ensured all financial and CEO characteristics data were available for consecutive years to mitigate the possibility of estimation bias. Any missing financial data were filled up using the public financial figures from the financial statement. The missing demographic profiles were extracted from the bank website, Bloomberg, LinkedIn and Wikipedia. We obtained 15 commercial banks with 90 observations after removing the commercial banks without the essential data.

Estimation Regression: To test the research hypothesis, we adopted the regression model from Gupta & Mahakud (2020), Khan et al. (2021) and Pham (2023). In this study, we measure the CEO working by three measurements – CEO total working experience (CWTE), CEO working experience within the bank (CIWE) and CEO working experience outside t tan (CO). The regressions are as follows:

$$\mathrm{ROA}_{it} = \beta_1 + \beta_2\mathrm{CTWE}_{it} + \beta\ \ \mathrm{FC}_{it} + \beta_4\mathrm{BS}_{i} + \beta_5\mathrm{BA}_{it} + \beta_6\mathrm{BC}_{it} + \beta\ \ \mathrm{LEV}_{it} + \beta_7\mathrm{DG}_{it} + \mu_{it} \quad \text{(Equation 1)}$$

$$\mathrm{ROA}_{it} = \beta_1 + \beta_2\mathrm{CIWE}_{it} + \beta_3\mathrm{FC}_{it} + \beta_4\mathrm{BS}_{it} + \beta_5\mathrm{BA}_{it} + \beta_6\mathrm{BC}_{it} + \beta_7\mathrm{LEV}_{it} + \beta_7\mathrm{DG}_{it} + \mu_{it} \quad \text{(Equation 2)}$$

$$\mathrm{ROA}_{it} = \beta_1 + \beta_2\mathrm{COWE}_{it} + \beta_3\mathrm{FC}_{it} + \beta_4\mathrm{BS}_{it} + \beta_5\mathrm{BA}_{it} + \ {}_6\mathrm{BC}_{it} + \beta_7\mathrm{LEV}_{it} + \beta_7\mathrm{G}_{it} + \mu_{it} \quad \text{(Equation 3)}$$

Where ROA is the dependent variable. CTWE, CIWE and COWE are the independent variables. The control variables are FE, BS, BA, BC, LEV, and DG. The full name, abbreviation and measurement of the variables were tabulated in Table 1.

Table 1: Measurements and Abbreviations of Dependent and Independent Variables

Abbreviations	**Variables**	**Measurement**
ROA	**Return on Assets**	**Net profit divided by Total Assets**
CTWE	CEO Total Working Experience	The total years of working experience the CEO works within the bank and the number of years they work outside the bank.
CIWE	CEO Inside Working Experience	The year of working experience The CEO works within the bank
COWE	CEO Outside Working Experience	The year of working experience The CEO works outside the bank
FC	CEO Financial	The dummy of 1 if the CEO has financial education and 0

	Education	otherwise
BS	Bank Size	The natural log of total assets
BA	Bank Age	The natural log of a bank's age since established adjusted in years.
BC	Bank Capital	The ratio of total equity to total assets
LEV	Leverage	The ratio of total liabilities to total assets
DG	Deposit Growth	The percentage growth in deposits

Estimation Method: We used the fixed effect model with robust standard errors to estimate the regression. Before deciding on the estimation method, we ran the pooled ordinary least squares (OLS) method and then the random effect method to identify the preferable method for estimation. The Breusch-Pagan LM test result shows the p-value was greater than 0.05 (p-value>0.05)[2]; thus, we concluded that OLS is more appropriate than the random effect method. Once OLS was selected, we performed the Chow test to decide whether OLS or the fixed effect model was more suitable for estimating the regression. The Chow test result shows that the P-value is less than 0.05 (p-value<0.05)[3]; therefore, we conclude that each firm has a different intercept and a fixed effect model would be more appropriate to generate reliable and efficient estimators. The fixed effect model's diagnostic check shows a heteroskedasticity detection on the model. The probability chi-square p-value is less than 0.05 (p<0.05)[4], which signifies the presence of heteroskedasticity, in which the variances are not constant. Therefore, we rectify the FE model using the option (robust) in Stata 17.

4. Results and Discussion

Table 2: Descriptive Statistics of Dependent and Independent Variables

	Mean	SD	Min	Max
Return on Assets (ROA)	0.0997	0.00568	-0.0219	0.0250
CEO Total Working Experience (CTWE)	35.20	12.28	21	80
CEO Inside Working Experience (CIWE)	5.111	3.731	1	19
CEO Outside Working Experience (COWE)	30.09	9.078	20	61
Finance CEO (FC)	0.7333	0.4447	0	1
Bank Size (BS)	17.84	1.879	14.54	20.60
Bank Age (BA)	38.63	17.65	16	87
Bank Capital (BC)	0.119	0.0461	0	0.290
Leverage (LEV)	0.0424	0.0362	0	0.131
Deposit Growth (DG)	0.0331	0.135	-0.411	0.972

Table 2 displays the descriptive statistics of all variables in this study. The mean value of ROA was 0.00997 ranging from -0.0219 to 0.0250. The negative findings show that some commercial banks suffered net losses during observation. However, not all commercial banks incurred net losses, as the mean and maximum values were positive. The average total working experience (CTWE) of the CEO is about 35 years, with a minimum of

[2] The Breusch-Pagan LM test has the null hypothesis of $\sigma_{\lambda}^{2} = 0\ (Pooled\ OLS)$ and alternate hypothesis of $\sigma_{\lambda}^{2} > 0\ (Random\ Effect)(Heterogeneity)$. Our finding showed a P-value of 1.0000, thus we failed to reject the alternate hypothesis and concluded the pooled OLS is preferable compared to random fixed effect.

[3] The Chow test has the null hypothesis of common intercept and alternate hypothesis of different intercept. Our result showed a p-value of 0.0000, therefore we accepted the alternate hypothesis and concluded that Fixed effect method is preferable compared to Pooled OLS due to different intercept.

[4] The detection of heteroskedasticity is tested via Modified Wald statistic for groupwise heteroskedasticity. Null hypothesis: Homoskedasticity and alternate hypothesis: Heteroskedasticity. The P value that we obtained was 0.0000. Thus, we accepted the alternative hypothesis and concluded the presence of heteroskedasticity of our models. We also detect the serial correlation through Wooldridge test for autocorrelation. We found a p-value of 0.2157 that was greater than 0.05. Thus, we did not find the existence of serial correlation in our Models.

21 and a maximum of 80 years. The sample of this paper demonstrated that the average working experience within the bank (CIWE) was 5.111 years ranging from 1 to 19 years. Over the six years, the average working experience outside the bank was 30.09 years ranging from 20 to 61 years. These findings indicate that the commercial banks are managed by the CEO, who has working experience within and outside the banks. Moreover, the variance of inflation factors (VIF) value for the variables was 2.47 (as in Law (2018), VIF <10), proving the absence of multicollinearity issue of our study models.

Table 3: Regression Results for the Relationship between CEO Experience and Commercial Bank Performance

	Model 1	Model 2	Model 3
CEO Total Working Experience (CTWE)	0.013*** (4.55)		
CEO Inside Working Experience (CIWE)		0.002*** (3.20)	
CEO Outside Working Experience (COWE)			0.029*** (4.07)
Finance CEO (FC)	0.003** (2.48)	0.002* (1.85)	0.005*** (4.03)
Bank Size (BS)	-0.024** (-2.30)	-0.023* (-1.97)	-0.026** (-2.51)
Bank Age (BA)	-0.068** (-2.73)	-0.066** (-2.52)	-0.072** (2.89)
Bank Capital (BC)	0.038* (1.91)	0.035 (1.71)	0.030 (1.54)
Leverage (LEV)	0.122 (1.57)	0.116 (1.42)	0.129 (1.69)
Deposit Growth (DG)	0.016* (1.93)	0.016* (1.95)	0.016* (1.84)
R-squared	0.446	0.433	0.443

Notes: The table shows the regression result of Eq 1 based on the fixed effect robust estimation method. ***, ** and * denote the significance level at 1%, 5% and 10%, respectively. Figures in brackets are t-statistics.

Table 3 shows the regression results for equations 1, 2 and 3 using different measurements for CEO experience – total working experience, experience working within the banks and experience working outside the banks, respectively. The coefficient of CTWE (β_2 = 0.013) in Model 1 was positive and significant at a 1% confidence level. This implies that increase in one-year CEO total working experience, the commercial bank performance increased by 101.31%. Meanwhile, in Model 2, the coefficient of CEO experience measured by working experience within commercial banks (CIWE) was 0.002 and significant at a 1 % confidence level. The result implies that increasing one year of working experience within commercial banks improves the return on assets for commercial banks by 100.2%. Moreover, the coefficient of COWE (β_2 = 0.029) was positive and significant at a 1% confidence level. The result shows that by increasing one unit of CEO working experience outside the bank, the commercial bank can improve its financial performance by 102.94%. As we observed from the results in Models 1, 2 and 3, CEO experience – total working experience, experience working within the banks and experience working outside the banks, improved the commercial bank performance in Malaysia. The positive relationship could be due to the better ability of well-experienced CEOs to make accurate decisions when dealing with complex banking environments and their encouragement to align their personal goals with the commercial banks' goals to work effectively and efficiently with the team.

More experienced CEOs have more knowledge, broader perspectives, and better cognitive skills in managing commercial banks' operations and enhancing financial performance. Our findings are consistent with Jiang et al. (2013), Gupta & Mahakud (2020) and Pham (2023), who found better performance and firm operation when managed by a well-experienced CEO. However, our findings do not align with Liu & Jiang (2020) and Erickson et al. (2015), which inferred an inverse relationship between CEO experience and firm value. The findings are supported by the Upper Echelon Theory (Hambrick & Mason, 1984) and Stewardship Theory (Donaldson & Davis, 1991) which explain the performance as a reflection of the cognitive skills of the executives who managed the firm for the former and a greater sense of ownership when the CEO served longer in the firms for the latter. Since the results are significant at a 1% confidence level for the CEO experience, we accepted the Ha. We concluded that CEO experience positively correlates with commercial banks' performance in Malaysia. On the control variables, FC has a positive relationship with the commercial banks' performance for Models 1, 2 and 3. This indicates that the CEO with finance expertise has better knowledge of managing commercial banks. BS and BA inversely impacted the return on assets of the commercial banks. This shows that smaller and younger commercial banks have better prospects of generating net income using their assets. DG was positively related to the commercial banks' performance. This implies that growing deposits can enhance Malaysia's commercial bank performance.

5. Conclusion

Our paper examines the effect of CEO experience on commercial banks' performance in Malaysia from 2016 to 2021. The results portray the importance for the CEO of having working experience outside the banks compared to working experience within the banks to enhance the commercial banks' performance. Total working experience from both within and outside the bank also strengthened the commercial bank's performance. Consistent with the Resource Dependency Theory, we show that the CEO is a vital resource for the commercial bank in determining the bank's performance in Malaysia. Our results on the CEO experience were consistent with the Upper Echelon Theory, in which a well-experienced CEO is essential to strengthening the banks' performance, and their skills are reflected in the performance of generating net profit based on the total assets of the commercial bank in Malaysia. The empirical findings are expected to contribute to the literature regarding how the CEO's experience impacts commercial banks in Malaysia and to guide the practitioner in formulating the hiring policy for the CEO.

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