GOVERNANCE IMPACTS ON BANKING PERFORMANCE

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Abstract
The importance of corporate governance and the essential role of banks as important financial institutions in a free capital market attract more attention of researchers and academicians to identify the relationship among corporate governance and banking performance. In the light of that, the paper seeks to specify the variables of corporate governance and banking financial performance through measuring the governance impacts variables on banking performance through an empirical study on banks during 2005-2014 in the Middle East. A strong relationship between these variables and banking financial performance is determined where is a positive relationship among the return on assets and the board of directors and on another hand a negative relationship is found between the banking performance and owner concentrations.

Keywords*:* Corporate Governance, Banking system, Financial Performance, Board of directors.

JEL Classification: *M4, M2,M11*

1. Introduction

The corporate governance has been highlighted and pointed as a high discussed topic due to the tragedy events that the global economy has had. Due to the Asian financial crisis in 1997 and later the Enron scandal in

2003 reaching to the high potential of another global financial crisis due to certain changes in the American financial structures, the corporate governance has earned its importance as a comprehensive perspective that solves the drivers of financial crisis and determines the prevention possibilities of other crises' factors. The majority of researchers commonly agree on the role of corporate governance in sustainability, low risk and high performance of any financial bodies as owned by states or private corporations. In addition, the impacts of corporate governance over banks gain more importance especially the transactions in the banking system are ramified and more complicated in front of other financial institutions, therefore, the concept of corporate governance becomes widely discussed and is considered as a complex combine between several factors of management corruption, the internal policies, the state codes and other concerned factors. Due to that, there is a statistic clue on the governance impacts and banking performance that proves a positive relationship between the impacts and board of directors and the general financial performance; the return on the equity is increased as a result of adopting corporate governance.

2. Corporate Governance

Till nowadays, there is no a single definition about governance, a few institutions such as the International Finance Corporation (IFC) defines it as the system that helps executives to manage and control their companies. Besides that, The Organization for Economic Cooperation and Development (OECD) defines corporate governance is as mechanisms that connects between several parties; executives, management council and boards, shareholders and others. In the light of that, corporate governance is more about a run-method of the corporation and about mechanisms that deal with stakeholders in order to achieve the objectives of these stakeholders. Due to the general perspective, governance refers to the existence of certain systems that control the relationship among stakeholders especially the board of directors, executive council and shareholders in order to achieve transparency, justice and reduce corruption in the firm, also, it ensures accountancy over directors' activities to make sure that the corporation is going to achieve its objectives and strategies in the long term and to reach sustainability.

The appearance of corporate governance in the last few decades is due to financial crises and economic collapses in the twenty century certainly in Eastern Asia and former communist countries besides United States of America and Europe. The first crisis occurred in the Eastern Asia; Japan, Korea and Malaysia in 1997 and at that time, huge corporation had a serious problem with liquidity and faced a high risk of collapsing. Due to that, certain governance standards were issued to assure the right of all stakeholders besides the rights of shareholders. The importance of governance standards are increased when several countries adopt a free market and switch to capitalism and that is based on big corporations in order to achieve a continued growth in economy. The free market encourages the capital mobilization among countries, which leads to increase the corporations' volume and its turn lead to separate the management from the equity. That separation generates certain important issues presented in the weakness of monitoring system and controlling tools over the managers and executives. That reflects clearly throughout corporations' corruption and financial crisis such as Enron scandal which was directly related to the lack of accuracy of financial reports and in the light of that Sarbanes-Olexy Act was issued in 2002. Accordingly, the positive relation between governance and firm performance is witnessed and that is the motivation of determine the relationship between corporate governance and bank performance since banks have an important role in pushing the economic wheel, also, the transaction among banks affect the micro and the macro economies.

3. Banking Sector

As a historical view, the international banks are back to 4000 years, when letter of credit was used beside exchange bill across sovereign boundaries to fiancé trades. In plus, bank as a word, has been used since fifteenth century. International banking is a need based on global economy since it provides liquidity and finance resources around the world. Starting with 1990, the international banks gain their importance to develop economies in Capitalism countries and to be used as a political method to involve in the economies of the former communist countries. During that period, the international banks become important financial institutions and to be changed massively in the light of international competition with other global international institutions, and after then years, Hughes and MacDonal said that the definition of bank is taken to be studied again to be redefined again. The banking sector in developed countries has been experienced radical scandals and improvements besides events such as mergers, privatization and competition. Due to that, the German and Canadian banking sectors are ones of strongest and efficient at the global level to be copied in the United States of America and Gulf Area in the Middle East. Nowadays, this sector has involved more in the economy at micro and macro levels in the light of free capital market to easy global credits, even so, the base of this sector is the same base of any firm that have conflicts between owners and managers due to the agency theory and more complicated when the interests of stakeholders are affected with the issued strategies and policies.

3. Governance in banking sector

The financial crisis of 2008 was known as a credit crisis represented the need of good governance to improve bank performance through highlighting the conflicts of agency theory and adopting stakeholder theory. Banks as firms concern on the investors protection where corporate governance has codes and mechanisms to be processed and that enables banks to access capital markets due to better terms (Doidge; 2004), in addition, good governance improve the performance at higher market value to increase the returned earning on shares (Gompers, Ishii & Metrick; 2003). Therefore, corporate governance is affected by the manners of bank business which is governed, and corporate governance contents relationships among the bank departments; management, board, shareholders and other internal and external stakeholders.

In accordance to the banking perspective, governance is represented in the possibilities of managing the issues in the banking management structure which are related directly to the bank's objectives in according with other stakeholders interests. The importance of adapting corporate governance in the banking sector is high increased comparing with other financial institutions, since bankruptcy impacts are not limited on the direct stakeholders; clients, owners, management; but they affect the performance of other banks and that is called ***interbank market***, that means the financial performance of banking sector is affected and consequently, a crisis on the macro economy takes a place. Besides that, the widely adapting information technology and free mobile- capitals forces the issues to be at an international level.

In addition, this relation between governance and banking sectors are more complicated since this sector has its specialties through dealing with assurance on deposits, risk invest management, the loan capital and loan conditions, and capital structure. Therefore, the monitoring mechanisms of corporate governance is more strict comparing with other financial institutions since there are huge integrated relations inside banking sectors. Here, the importance of adopting corporate governance in this sector is presented, especially; it increases the quality of banking services and reduces the risk management.

In the light of that, applying corporate governance in this sector is related to certain factors which can be divided to internal and external factors.

- Internal factors: are presented in principles and rules that control the procedures of making decisions and distribute the responsibilities between the equity council and board of directors. Thus, corporate governance through its mechanisms reduces the internal conflicts.
- External factors: are presented in organization factors related to the investment atmosphere in a country, the states codes and legalizations, competition in the banking sector and the relationships with other financial institutions. Therefore, corporate governance concern at this level on the external conflicts.

In accordance with that, the role of central banks is essential in encouraging banks to adopt corporate governance throughout monitoring and controlling mechanisms and assuring high internal auditing quality.

4. Briefly empirical study

The typical measure includes variables depend on the return earning on the equity which expresses the financial performance for selected banks in Gulf area. Besides these variables, there are five independent variables related to corporate governance: the board of directors' size and the number of independent directors, board committees, percentage of shares owned by big owners and the bank activities volume.

Variables	Name	Symbol	Measurement
Dependent	Performance	ROA	Earning return on equity = net profit / total asset
Independent	BOD size	BSZ	Numbers of managers and executives
Independent	Independent directors	BCM	Numbers of independent directors
Independent	Equity percentage of owners	OCN	Shares owned by big owners
Independent	Bank activities	SZE	Total bank assets
β1- β5	factors of independent variables		
εit	Random error		

The formulations:

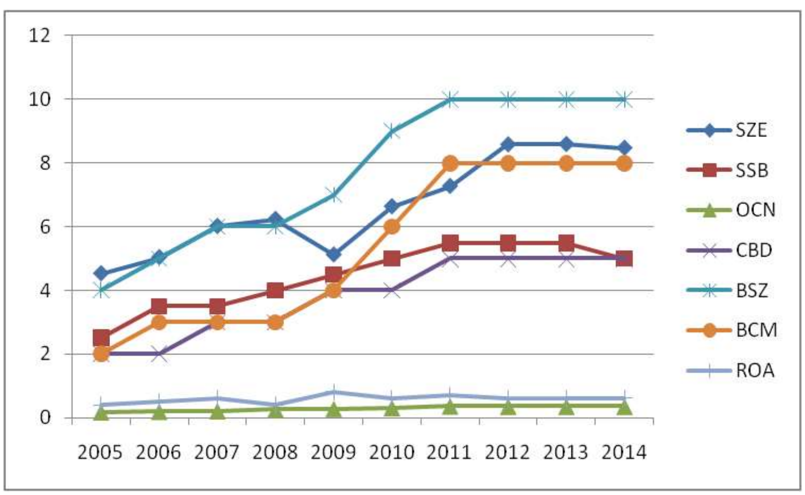
ROA it= α0+ β1BCMit+ β2BSZit+ β3CBDit+ β4OCNit+ β5SSBit+ β5SZEit+ εit

The samples are selected randomly and collected data from ZAWYA, the medium of developing in the banking sector is as the following:

SZE	SSB	OCN	CBD	BSZ	BCM	ROA	
4.53	2.5	0.17	2	4	2	0.4	2005
5.04	3.5	0.19	2	5	3	0.5	2006
6.02	3.5	0.21	3	6	3	0.6	2007
6.24	4	0.25	3	6	3	0.4	2008
5.12	4.5	0.28	4	7	4	0.8	2009
6.64	5	0.31	4	9	6	0.6	2010
7.28	5.5	0.36	5	10	8	0.7	2011
8.59	5.5	0.36	5	10	8	0.6	2012
8.61	5	0.37	5	10	8	0.6	2013
8.65	6	0.37	5	10	8	0.7	2014

Resource: Chawki & Halimgherbi; 2014, Auditor 2017

The volume of selected banks' activities is increased besides other variables are increased continuously; the number of independent directors of board of directors are increased to meet the increased of independent executives in committees. Over all highlights the increased percentage of the performances of selected banks to assure the role of adopting corporate governance in the banking sector.



The chart based on the previous table

In accordance of that, the analyzed data ensures the positive relationship between governance impacts and banking performance, especially, autocorrelation is not determined in the study since the Durbin Watson factory is 2.53.

Conclusion

The stakeholder theory of corporate governance finds its own way to involve in the bank performance to reduce the conflicts among stakeholders' interests since the internal stakeholders; owners, executives, directors; and the external stakeholders; depositors, states, concerned institutions. Basically, the main concern is about the major party own more shares in the bank capital to affect the bank's strategies and policies that may affect others of stakeholders. Besides that, owners, directors and executives in banks show their efforts to implement good governance in order to increase the market credibility of their banks; consequently, they will bring funds to their banks at lower cost and lower risk that definitely refers to the positive relationship between corporate governance and bank performance.

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