CORPORATE GOVERNANCE PRACTICES AND THE ROLE OF THE BOARD OF DIRECTORS: EVIDENCE FROM UAE CONVENTIONAL AND ISLAMIC BANKS

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Abstract

The purpose of this study is to examine the United Arab Emirates (UAE) national banks' practices of corporate governance regarding the role of the board of directors in the formulation and implementation of bank policies and strategies. A questionnaire has been developed using established reliable and valid measures of certain characteristics of corporate governance with minor modifications to fit the context. The results indicate that the UAE banks' board of directors are satisfied with the compensation system; they are aware of the importance of the relationship with the shareholders; they understand and develop a good relationship with stakeholders; the composition of the UAE banks' board of directors is appropriate; meetings of the UAE banks' board of directors are effective and productive; the UAE banks' board of directors are satisfied with the chairman's leadership skills and performance; and finally, the UAE banks' board of directors are aware of the requirements of corporate governance practices. Furthermore, the results indicate that there is a significant positive relationship between the role of the UAE banks' board of directors and their education background, as well as their experience, compensation and corporate governance awareness. In addition, the statistical results confirmed that there is no significant difference in the role of the board of directors between the UAE conventional banks and Islamic banks.*

Keywords: Corporate Governance Characteristics Role of The Board Of Directors, UAE National Banks, UAE Islamic Banks

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Introduction and Objective

There are 23 United Arab Emirates (UAE) national banks, of which 15 are conventional banks and the remaining 8 are Islamic banks. In 2011, the market share of Islamic banks was 7.6 percent of the UAE banking sector's total assets and 10.4 percent of the UAE national banks' assets. In 2011, this market share was dramatically increased to reach 16.2 percent and 21.5 percent respectivly. The number of branches of UAE Islamic banks in 2011 was 265 compared with 791 branches of the national conventional banks and 111 branches of foreign banks, representing 22.7 percent of the total branches of UAE commercial banks. It is worth mentioning here that the UAE banking sector also includes 28 foreign banks (i.e., branches of foreign banks), and for the purpose of this study it was not possible to cover these banks as the head offices and therefore the board of directors are outside the UAE (Emirates Banks Associations and UAE Central Bank).

The objective of this study is to examine the UAE national banks' practices of corporate governance regarding the role of the board of directors in the formulation and implementation of bank policies and strategies. As a result of the 2007/2008 financial crisis, corporate governance became crucial for growth and development, particularly for commercial banks (Polo, 2007). Therfore, there is a need to examine corporate governance from different angles. The current study concentrates on different aspects of corporate governance practices, namely the role of the board of directors, their perceptions, and how they view their role. In addition, the study examines how they view their relationship with the shareholders, the stakeholders, the compensation received, the meetings of the board, the role of the chairman and their indiviual role as members. To the best of the authors' knowledge, there has been no such study conducted on UAE national banks, and this lack represents the main motivation for the current study.

The structure of the paper is as follows. In the first section, a literature review of the most recent studies is provided. The second section deals with the research questions and hypotheses, followed by an exposition of research methods and data collection. The fourth section is devoted to discussion of the empirical findings. In the final section a brief summary of the paper and conclusions concerning the main results are provided.

Literature Review

A great deal of research has been conducted on corporate governance in general, corporate governance and performance, the role of the board of directors and characteristics of the board of directors. Regarding these characteristics, many studies have emphasized ownership, independence, CEO duality, composition and compensation; there has been much less focus on education background and business experience. The current study mainly deals with these two characteristics, in addition to compensation, corporate governance awareness and the relationship with shareholders and stakeholders. This section briefly highlights the results of some empirical studies on corporate governance practices and the role of the board of directors.

The role of boards of directors in the financial crisis has been examined by Castellano et al. (2011). Their study covers the boards of 21 US financial institutions—11 that survived the recent financial crisis and 10 that did not survive. They concluded that the majority of both surviving bank directors and failing bank directors demonstrated little or no background or experience in the financial service or banking industries. The authors expected to find that the boards of the surviving banks had more industry-specific experience than those of the failed banks; but they found the opposite was true.

Chiao and Wu (2012) examined the relationship between four board characteristics (ownership, independence, CEO duality and compensation) and audit fees in Taiwan listed companies. They found that concentrated board ownership is related to lower audit fees, and higher board compensation is related to higher audit fees. In addition, they found that the relationship between CEO duality and audit fees was weaker when the board of directors holds concentrated ownership.

Gantenbein and Volonté (2011) investigated how the education and business experience of directors affect firm performance. The results of their study indicate that education and business experience are negatively related to performance. Regarding experience, the results reveal that international experience impacts firm valuation. In addition, females are positively related to firm performance if they are economists and have CEO experience.

Hsueh-En Hsu (2010) examined the relationship between board characteristics and financial performance of United States initial public offerings. He indicated that board characteristics include board independence (i.e., outsider-dominated boards), board quality (i.e., board expertise and educational background) and venture capital directors. The empirical results reveal that board independence is negatively related to firm performance. The author indicated that as expected, board quality is positively related to firm performance. However, there is no evidence that venture capital directors are positively associated with financial performance.

O'Connell and Cramer (2010) investigated the association between firm performance and both board size and board composition for companies quoted on the Irish Stock Market. The study also examined the impact of firm size on the relationship between firm performance and board characteristics. The study found evidence that board size exhibits a significant negative association with firm performance, the relationship between board size and firm performance is significantly less negative for smaller firms, and a positive and significant association between firm performance and the percentage of non-executives on the board is apparent.

Yammeesri and Herath (2010) examined the influence of independent directors on firm performance based on a sample of Thai non-financial listed companies. Their study also focused on the importance of inside directors, grey directors and board size on corporate performance. Furthermore, it illustrated the importance of the relationship between board composition and corporate valuation. The results indicate that a larger board membership is less likely to improve firm performance. The results also indicate that neither independent directors nor grey directors are the significant determinants of improving firm value. Finally, the results indicate that inside directors can perform an excellent management role in increasing firm value.

Nicholson and Newton (2010) highlighted how directors and senior managers perceive the role of a board in regard to compliance and risk, strategy, governance (responsibilities of the board) management development role, and managing stakeholders. They found that managers and directors perceive board effectiveness as linked to different combinations of these roles and that there appear to be differences in perceptions between different types of firms. They concluded that the relationship between board roles and perceived board effectiveness differs between managers and directors.

The relationship among board of director characteristics, corporate social performance and corporate financial performance was investigated by Dun and Sainty (2009). The main purpose of their paper was to investigate the link between qualitative measures of a firm's board of directors and its corporate social performance. The main findings of the study were that board independence is positively related to social performance but shareholder orientation is not. In addition, the study found a positive relationship between social performance and both financial performance and debt.

De Andres and Vallelado (2008) examined the role of the board of directors in large international commercial banks to test hypotheses on the dual role of boards of directors. The sample consisted of 69 banks from six OECD countries. They used an econometric model (two-step system estimator) to solve the problem of endogeneity in corporate governance. The study found an inverted U-shaped relation between bank performance and board size, and between the proportion of non-executive directors and performance. The results also indicate that the bank board composition and size are related to directors' ability to monitor and advise management, and that larger and not excessively independent boards might prove more efficient in monitoring and advising functions, and create more value.

Robert et al. (2008) examined the effects of board size and 'busy' directors on the market value of Italian companies. Among the findings of this study is that the level of 'busy-ness' of corporate directors as a measure of board effectiveness has a significant influence on firm's market performance. However, the study found limited evidence that board size has a substantial impact on the market valuation.

The relationship between board characteristics (the association of board independence, CEO duality, board size, and board tenure) and performance in Turkish commercial banks was investigated by Kaymak and Bektas (2008). The study used data from 27 commercial banks. The main findings indicate that the presence of insiders has a positive impact on return on assets, while duality and board tenure are negatively associated with performance.

Perry and Shivdasani (2005) reached the conclusion that the board of directors is one of the most important mechanisms used by the shareholders to monitor management, as the characteristics of the board can control management and therefore enhance the performance of the firm.

Bennett and Robson (2004) examined the role of boards of directors in small and medium-sized firms. The main finding of their study indicate that there is little evidence of a strong association of board size, board qualifications, or board structure with firm performance.

Research Questions and Hypotheses

Research Questions

This study attempts to answer the following questions:

1. Are UAE banks' board of directors satisfied with the compensation system?
2. Are UAE banks' board of directors aware of the importance of the relationship with shareholders?
3. Do UAE banks' board of directors understand and develop a good relationship with stakeholders?
4. Is the composition of the UAE banks' board of directors appropriate?
5. Are UAE banks' board of directors' meetings effective and productive?
6. Are UAE banks' board of directors satisfied with the chairman's leadership skills and performance?
7. Are UAE banks' board of directors aware of the requirements of corporate governance pratices?

Research Hypotheses

Based on the purpose and the questions stated above, the following hypotheses are formulated:

H1. There is a significant positive relationship between the role of the UAE banks' board of directors and their education background, their experience, their relationship with the shareholders and stakeholders, compensation and corporate governance awareness.

H2. There is no significant difference in the role of the board of directors between the UAE conventional banks and Islamic banks.

Research Methods and Data

Research Instrument

The questionnaire used in this study was modified from three surveys already developed and in use: the Board Self-Evaluation Questionnaire developed by Dalhousie University in 2005, the Union Arab Bank questionnaire created in 2007 and the China Corporate Governance Survey conducted by CFA Institute in 2007.

The modified questionnaire is divided into two parts. The first part covers general information, namely the type of the bank, number of years of board of directors membership and education background.

The second part consists of 44 questions using a 5-point Likert scale ranking from 1 (completely untrue) to 5 (completely true). Ten questions are about the role of the board of directors (ROL); three questions are devoted to compensation (COMPN); four questions are about the relationship with shareholders (SHAR); three questions are assigned to composition (COMPS); two questions are devoted to the relationship with stakeholders (STAK); four questions are about meetings of the board of directors (MEET); eight questions are assigned to the role of the chairman (CHAIR); and the last ten questions are about the awareness of individual board members regarding corporate governance practices (AWAR).

However, although the questionnaire used is mainly based on three previously tested questionnaires, the researcher eliminated, added or reworded some of the questions included in the first draft. To assess the scales' content validity, the questionnaire draft was piloted by three academicians and five practitioners, to examine the scales, as was suggested by Devellis (1991).

Sampling and Data Collection

The targeted population of this study was members of the board of directors. The total number of board members when the researcher and his research assistants started distributing the questionnaire at the beginning of 2011 was 141 from conventional banks and 62 from Islamic banks. This was a very difficult task, as it is not easy to meet with busy board members even for a few minutes, and this was the case for the majority of the board members. The researcher and his research assistants tried very hard to utilize all possible communication channels: individual interviews, emails, telephone calls and visits to board members' personal offices. However, we ended up with 43 usable responses (12 of which were from Islamic banks) representing about 21 percent of the total targeted population, which is acceptable for research purposes (Nicholson and Newton, 2010).

Reliability

Reliability of the measures was assessed with the use of Cronbach's alpha, which is used to estimate how much variation in scores of different variables is attributable to chance or random errors (Selltz et al., 1976). As a general rule a coefficient greater than or equal to 0.7 is considered acceptable and a good indication of construct reliability (Nunnally, 1978). Cronbach's alpha for the eight characteristics ranges from .793 to .708. These Cronbach's alpha values indicate that all of the characteristics are reliable (see Table 1).

Tabble 1. Corporate Governance Characteristics and Their Internal Consistency

Characteristics	**Items–Part II of the Questionnaire**	**# of Items**	**Alpha**
ROL	Items 1-10	10	.764
COMPN	Items 11-13	3	.793
SHAR	Items 14-17	4	.752
COMPS	Items 18-20	3	.708
STAK	Items 21-22	2	.726
MEET	Items 23- 26	4	.752
CHAIR	Items 27- 34	8	.718
AWAR	Items 35- 44	10	.720

Descriptive Statistics

Table 2 provides descriptive statistics for the eight characteristics of corporate governance. Mean values shown in Table 2 indicate that the mean value for all characteristics is more than 2.5 ; this value gives a positive answer on the research questions. The mean values reveal that the UAE banks' board of directors were satisfied with the compensation system; they were aware of the importance of the relationship with the shareholders; they understood and developed a good relationship with stakholders; the composition of the UAE banks' board of directors was appropriate; meetings of the UAE banks' board of directors were effective and produtive; the UAE banks' board of directors were satisfied with the chairman's leadership skills and performance; and finally, the UAE banks' board of directors were aware of the requirements of corporate governance pratices.

Table 2. Descriptive Statistics

	N	Minimum	Maximum	Mean	Std. Deviation
ROL	43	3.30	5.00	4.1767	.32502
COMPN	43	3.33	5.00	4.2558	.44148
SHAR	43	2.50	5.00	3.5581	.51129
COMPS	43	2.67	5.00	3.6667	.57735
STAK	43	3.00	5.00	3.8605	.59086
MEET	43	3.50	5.00	4.0116	.39699
CHAIR	43	3.63	5.00	4.2035	.37601
AWAR	43	3.10	5.00	3.7465	.44580

Results of Testing the Research Hypotheses

In order to test the two research hypotheses, a linear regression analysis was performed with the role of the UAE banks' board of directors (ROL) as the dependent variable and four independent variables: business experience (EXP), education background (EDU), compensation (COMPN) and the awareness of individual board members (AWAR). It is assumed that the positive role of the board of directors affects positively their bank's performance. In this regard there are a large number of empirical studies that deal with the relationship between firm (bank) performance and different corporate governance characteristics. As examples of such studies, in addition to those mentioned in the literature review section, see: Yammeesri and Herath (2008), Neill and Dulewicz (2010), Andres and Vallelado (2008), Neill and Dulewicz (2009), Huang(2010), Liu and Fong (2009), Juras and Hinson (2008), and Mishra and Nielsen (2000).

Before examining the contribution of the above-mentioned independent variables to the regression model, a multicollinearity test was conducted and some of the independent variables were dropped because of the strong relationship between these variables. Accordingly, the regression model used is as follows:

$$ROL = f(EXP, EDU, COMPN, AWAR)$$

Where:

ROL= role of the board of directors
EXP = experience
EDU = education background
COMPN = compensation
AWAR = awareness of individual board members

Table 3 reveals the results of the regressions model. It can be seen from the table that R square is .434. This indicates that the four independent variables (business experience, education background, compensation and awareness of individual board members) explain 43.4% of the variations of the role of the board of directors. The estimated coefficients of the four independent variables were, as expected, positive and statistically significant at the 1 percent level in the case of the compensation variable (COMPN) and at the 5 percent level in the case of business experience and the awareness of individual board members. However, the estimated coefficient of the education background was positive as expected but statistically insignificant.

Table 3. Summary of Regression Results

Independent Variable	Beta	t	Sig.
(Constant)		2.947	.005
EXP	.278	2.245	.031
EDU	.006	.050	.960
COMPN	.523	4.229	.000
AWAR	.290	2.267	.029
R Square: .434			
Adjusted R Square: .375			
Std. Error of the Estimate: .25700			

The results partially confirm the first hypothesis, in that there is a significant positive relationship between the role of the UAE banks' board of directors and their business experience, their education background, compensation and corporate governance awareness. It can be concluded based on the results provided in Tables 2 and 3 that the role of the board of directors was positive, as the mean of the responses was 4.17 out of 5, the maximum value of the scale used. The positive role of the board of directors is supported by the continued success and growth of both the conventional and Islamic banks. For example after the last financial crisis, the net income of UAE national banks increased by 15.96% in 2010 (Emirates Banks Associations, 2010), while at the same time there was a collapse and failure of many commercial banks all over the globe. It seems that the board of directors' positive role is mainly because the members are satisfied with the compensation system, which is consistent with the findings of Chiao and Wu (2012). Also of importance are long experience of service as a board member (for most of them, more than 10 years) and awareness of the requirements of corporate governance. This is inconsistent with the findings of Kaymak and Bektas (2008) and Bennett and Robson (2004). Unexpectedly, based on the regression results education background is not an influencing factor on the role of the board of directors in the presence of the other factors being considered. This is consistent with the findings of Hsueh-En Hsu (2010) and Castellano et al. (2011) and inconsistent with the findings with of Gantenbein and Volonté (2011) and Bennett and Robson (2004).

To test the second hypothesis which stated "There is a significant difference in the role of the board of directors between the UAE conventional banks and Islamic banks" One-Way ANOVA analysis was conducted, the results of which are presented in Table 4. The results indicate that there is no significant difference between the UAE national conventional and Islamic banks in the role of the board of directors regarding corporate governance practices, which means hypothesis two is confirmed. The results were expected because there are no specific qualifications required for board membership, therefore, the same person might be a board member of an Islamic bank or a conventional bank.

Table 4. The Results of Analysis of Variance for National Banks and Islamic Banks: The Role of the Board of Directors

Source	Sum of Squares	df	Mean Square	F	Sig.
Between Groups	.072	1	.072	.679	.415
Within Groups	4.364	41	.106		
Total	4.437	42			

Conclusions

The purpose of this study was to examine the UAE national banks' practices of corporate governance regarding the role of the board of directors in the formulation and implementation of bank policies and strategies. A modified questionnaire was used with two parts, the first of which covered general information, namely type of bank, number of years of board membership and education background. The second part consisted of 44 questions about eight characteristics of corporate governance, using a 5-point Likert scale ranging from 1 (completely untrue) to 5 (completely true). The targeted population of this study was the board of directors of UAE national banks. The total number of the population was 203, 141 of whom were from conventional banks and the remaining 62 from Islamic banks. In this study an attempt was made to answer six questions and two hypotheses. The research questions and hypotheses were developed based on the literature review provided.

The results indicate that the UAE banks' board of directors are satisfied with the compensation system; they are aware of the importance of the relationship with the shareholders; they understand and develop a good relationship with stakeholders; the composition of the UAE banks' board of directors is appropriate; the meetings of the UAE banks' board of directors are effective and productive; the UAE banks' board of directors are satisfied with the chairman's leadership skills and performance; and finally, the UAE banks' board of directors are aware of the requirements of corporate governance practices.

Regarding the two research hypotheses, the results indicate that there is a significant positive relationship between the role of the UAE banks' board of directors and their education background, their experience, compensation and corporate governance awareness. In addition, the statistical results confirmed the second hypothesis as expected: there is no significant difference in the role of the board of directors between the UAE conventional banks and Islamic banks. To conclude, although the results are positive on corporate governance practices and the role of the board of directors, there is of course still room for improvement in corporate governance practices. It is highly recommended to rely less on the most busy members, as some of them serve on many boards, sometimes as many as five or more simultaneously. It is also recommended to give more emphasis on the development of corporate governance culture by organizing training programs for this purpose.

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