THE EFFECT OF CORPORATE GOVERNANCE ON BANK FINANCIAL PERFORMANCE: EVIDENCE FROM THE ARABIAN PENINSULA

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Abstract

This paper investigates the effect of internal corporate governance mechanisms and control variables, such as bank size and bank age on bank financial performance. The sample of this study comprises of both conventional and Islamic banks operating in the seven Arabian Peninsula countries, namely Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, United Arab Emirates, and Yemen. Regression analysis (OLS) is used to test the effect of corporate governance mechanisms on bank financial performance. The results of this study reveal that there is a significant relationship between corporate governance and bank profitability. Board size, board activism, number of outside directors, and bank age significantly affect Tobin's Q. Meanwhile, ROA and PM are affected by ownership concentration, audit committee, audit committee meetings, and the age & size of the bank. The results are consistent with previous literature that the correlation between corporate governance and firm performance is still not clearly established and that impact of corporate governance on bank financial performance in developing countries is still relatively limited.

Keywords: Board Structure, Ownership Structure, Audit Committee, Corporate Governance Mechanisms, Bank Performance, GCC, Yemen

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1. Introduction

Corporate governance has become one of the most topical issues in the modern business world today. Spectacular corporate failures, such as those of Enron, Worldcom, Barlow Clows and Levitt, the Bank of Credit and Commerce International (BCCI), Polly Peck International and Baring Bank, have made it a central issue, with various governments and regulatory authorities making efforts to install stringent governance regimes to ensure the smooth running of corporate organizations, and prevent such failures. A corporate governance system is defined as a more-or-less country-specific framework of legal, institutional and cultural factors shaping the patterns of influence that shareholders (or stakeholders) exert on managerial decision-making. Corporate governance mechanisms are the methods employed, at the firm level, to solve corporate governance problems.

Corporate governance is viewed as an indispensable element of market discipline (Levitt 1999) and this is fuelling demands for strong corporate governance mechanisms by investors and other financial market participants (Blue Ribbon Committee 1999; Ramsay 2001). Regulators have enacted corporate governance reforms into law in many countries such as the USA (Sarbanes-Oxley Act, 2002). In other countries such UK (Combined Code of Corporate Governance, 2003) the corporate governance codes are principles of best practice with some indirect element of legislature operating through the respective stock exchange listing rules. For the banking sector, Basel II is widely adopted by developing and emerging market economies to enhance their CG codes.

Bank governance was altered tremendously during the 1990s and early 2000s, principally due to bank ownership changes, such as mergers and acquisitions (Berger et al. 2005; and Arouri et al. 2011). The worldwide financial crisis of 2008, which started in the United States, was attributable to U.S. banks' excessive risk-taking. Consequently, in order to control such risk and draw people's attention to the agency problem within banks, there are statements made by bankers, central bank officials, and other related authorities, emphasizing the importance of effective corporate governance in the banking industry since 2008 and until now (Beltratti and Stulz 2009; and Peni and Vahamaa 2011). Therefore, any similar crisis occurred or may occur in the future might be explained as a result of bank governance failure. Few studies have focused on banks' corporate governance (see Macey and O'Hara, 2003; Levine,

2004; Adams and Mehran, 2005; Capiro et al. 2007; Bokpin, 2013; Nyamongo and Temesgen, 2013).

This study focuses on banks operating in Yemen and the GCC countries in order to provide empirical evidence on the effects of corporate governance on bank performance. The rest of the paper is organised as follows: the following section provides a theoretical background and hypotheses development. The research methodology is provided in section 3, followed by the findings and analysis in section 4; and finally summary & conclusion are provided in section 5.

2. Theoretical Background and Hypotheses Development

2.1 Background

Traditional finance literature has indicated several mechanisms that help solve corporate governance problems (Jensen and Meckling (1976); Fama (1980); Fama and Jensen (1983); Jensen (1986); Jensen (1993); and Turnbull (1997). There is a consensus on the classification of corporate governance mechanisms to two categories: internal and external mechanisms. However, there is a dissension on the contents of each category and the effectiveness of each mechanism. In addition, the topic of corporate governance mechanisms is too vast and rich research area to the extent that no single paper can survey all the corporate governance mechanisms developed in the literature and instead the papers try to focus on some particular governance mechanisms.

Jensen (1993) outlines four basic categories of individual corporate governance mechanisms: (1) legal and regulatory mechanisms; (2) internal control mechanisms; (3) External control mechanisms; and (4) product market competition. Shleifer and Vishny (1997) concentrate on: incentive contracts, legal protection for the investors against the managerial self-dealing, and the ownership by large investors; they point out the costs and benefits of each governance mechanism. Denis and McConnell (2003) use a dual classification of corporate governance mechanisms (They use systems as synonym to mechanisms) as follows: (1) internal governance mechanisms including: boards of directors and ownership structure and (2) external ones including: the takeover market and the legal regulatory system.

Farinha (2003) surveys two categories of governance (or disciplining) mechanisms, the first one is the external disciplining mechanisms including: takeovers threat; product market competition; managerial labour market and mutual monitoring by managers; security analysts; the legal environment; and the role of reputation. The other category is the internal disciplining mechanisms which include: large and institutional shareholders; board of directors; insider ownership; compensation packages; debt policy; and dividend policy.

Despite the existence of different corporate governance structures, the basic building blocks of the structures are similar. They include the existence of a Company, Directors, Accountability and Audit, Directors' Remuneration, Shareholders and the AGM. Cadbury (1992), Greenbury (1995) and Hampel (1998) called for greater transparency and accountability in areas such as board structure and operation, directors' contracts and the establishment of board monitoring committees. In addition, they all stressed the importance of the non-executive directors' monitoring role. The relationship between corporate performance and corporate governance is measured using only one of the two variables: ownership structure and board structure (Krivogorsky, 2006).

Much of the empirical findings on corporate governance and performance in non-financial institutions are also applicable to financial institutions. However, the optimal designing of bank governance structure is very complex and important relative to unregulated, non-financial firms for several reasons. Mullineux (2006) argues that good CG of banks requires prudential risk-related regulation and attention to conflicts of interest and competition issues, particularly given the clear information advantage of banks over their retail customers. Banks are prudentially regulated and highly levered compared to other companies and hence bank governance deserves special attention (Adams and Mehran 2003).

Moreover, the stakeholders' interests at banks extend beyond the shareholders' interests since the bank depositors, creditors, and regulators have stakes in the banks as well. In addition to shareholders and managers, depositors and regulators have a straight stake in bank performance. Griffiths (2007) argues that borrowers have a legitimate claim on banks by entering in lending agreements, acquire power and urgency through their cause being adopted by other stakeholders such as regulators and consumer organisations. These stakeholders enjoy all three of Mitchell et al. (1997) stakeholder attributes: power, legitimacy and urgency (Yamak and Su¨er, 2005; Griffiths, 2007). Governments are also worried about banks reputations, and consequently regulate their governance, because a bank's failure negatively affects the respective country's economy, and may even spread globally, similar to what happened during the 1997 Asian financial crisis (Pathan et al. 2008) and the 2008 U.S. financial crisis (Peni and Vahamaa 2011).

Abu-Tapanjeh (2009) compares the OECD corporate governance principles with principles from Islam and declares them compatible; he points out that Islam as applied to business is entirely compatible with corporate governance. Honesty and trust that are key ingredients of an effective governance framework (OECD, 2004) are also basic to ethical behaviour in the Islamic Sharia (Gambling

and Karim, 1991; Tan, 2006; Taylor, 2008; Mohammed, 2009). Hence the first research hypothesis is:

H_1: There is no difference in adopting CG mechanisms between Islamic banks and conventional banks.

2.2 Board Structure

The board of directors is typically the governing body of the organization. Its primary responsibility is to make sure that the organization achieves the shareholders' goal. The board of directors has the power to hire, terminate, and compensate top management (Johnson et al. 2008). Therefore, it safeguards the organization's assets and invested capital. In addition to setting the bank's objectives (including generating returns to shareholders), the board of directors and senior management affect how banks run their daily operations, meet the obligation of accountability to bank's shareholders, and consider the interests of other recognized stakeholders (Basel Committee, 2004).

Nonetheless, there is a debate regarding the effect of board composition on firm performance (Dulewicz and Herbert, 2004; De Andres et al., 2005; Ehikioya, 2009; Mohamed et al., 2013). Bhagat and Black (2002) find a negative relationship between the proportion of outside directors and corporate performance. Moreover, Yermack (1996) reported evidence that a higher percentage of independent directors leads to worse performance. In addition, Klein (2002) suggests that high percentage of outside directors will have the same negative effect. On the other hand, several studies do not show any evidence of an existing relationship between the proportion of non-executive directors and firm performance (Dalton et al., 1998; Vafeas and Theodorou 1998; Laing and Weir, 1999). Pi and Timme (1993) find that banks cost efficiency and return on assets are not significantly related to the proportion of inside (outside) directors. While Alonso and Gonzalez (2006) document a positive relation between the proportion of non-executive directors and bank performance.

Moreover, several studies reveal that there is negative relation between the size of the board and performance (Hermalin and Weisbach, 1991; Eisenberg et al, 1998; Carline et al, 2002; Mak and Yuanto, 2003). Larger boards seems to be less efficient due to the slow pace of decision making and the difficulty in both arranging board meeting and reaching consensus. It is also argued that the CEO seems to have more dominant power when the board size is too large (Jensen, 1993; Yermack, 1996; Eisenberg et al, 1998; Singh and Davidson, 2003; Cheng, 2008). Staikouras et al. (2007) report ROA and ROE are statistically significant and negatively related to board size in European Banks. However, Huang (2010) finds positive significant relationship between the size of the board and bank performance in Taiwan.

It is not only the size of the board that seems to have a governing effect on firm performance, it is argued that the board composition in terms of the number of outside directors versus inside directors results in better performance through better monitoring. This argument is mainly based on the agency theory (Fama 1980; Demsetz and Lehn, 1985). Several studies find that the larger the number of outside directors on the board, the better the firm performance (Rosenstein and Wyatt, 1990; Weisbach, 1988; Huson, 2001; Mohamed et al., 2013). Huang (2010) finds positive significant relationship between the number of outside directors and bank performance in Taiwan.

On the other hand, some argue that based on the stewardship theory executive directors have a positive effect on corporate R&D costs and better performance based on improved strategic innovation (Donaldson, 1990; Kochar and David, 1996; Davis et al, 1997). Several studies reveal negative relation between the number of outside directors and firm performance (Agrawal and Knoeber, 1996; Kochar and David, 1996; Bhagat and Black, 2002). Meanwhile, several other studies find no significant relation between the number of outside directors and corporate performance (Hermalin and Weibach, 1991; Dalton et al, 1998; Vafeas and Theodorou, 1998; Laing and Weir, 1999; Lam and Lee, 2012). Further explanation is provided by Adams and Ferreira (2007) who suggest that CEOs may be reluctant to share information with more independent boards, thereby decreasing shareholder value.

Based on the agency perspective the separation of the roles of CEO from chairman is another crucial monitoring mechanism. CEO duality is problematic from an agency perspective as the CEO seems to get dominant influence on board decisions by chairing the group of people in charge of monitoring and evaluating his performance. This in effect results in weakening the board's independency and may result in ineffective monitoring of management. Therefore good governance will occur when the two roles of Chairman and CEO are separated (Baliga and Rao, 1996; Brickley et al, 1997; Coles and Hesterly, 2000; Weir and Laing, 2001; William et al. 2003).

Rechner and Dalton (1989) find no significant differences in firm performance between separated leadership structure firms and combined leadership structure firms over a five year period. However, further study of the same sample reveal that firms with separated leadership structure have higher performance than the firms with combined leadership structure measured with ROE, ROI and profit margin (Rechner and Dalton, 1991).

Saundaramurthy et al. (1997) provide evidence that separating the positions will affect the shareholder wealth positively. Moreover, Coles and

Hesterly (2000) find that firms that separate CEOs and board chairs will have better stock returns than firms that do not separate the two roles. On the other hand, Baliga and Rao (1996) do not find sufficient evidence to support a performance distinction between separated and combined leadership firms when the performance was measured using the market value added (MVA) and economic value added (EVA) as performance indicators.

Audit committees are identified as effective means for corporate governance that reduce the potential for fraudulent financial reporting (NCFFR, 1987). Audit committees oversee the organization's management, internal and external auditors to protect and preserve the shareholders' equity and interests. To ensure effective corporate governance, the audit committee report should be included annually in the organization's proxy statement, stating whether the audit committee has reviewed and discussed the financial statements with the management and the internal auditors. As a corporate governance monitor, the audit committee should provide the public with correct, accurate, complete, and reliable information, and it should not leave a gap for predictions or uninformed expectations (BRC, 1999). The BRC report provides recommendations and guiding principles for improving the performance of audit committees that should ultimately result in better corporate governance. The importance of the audit function in terms of the audit committee and audit firm is further strengthened by the Sarbanes-Oxley Act of 2002. The discussion above leads us to the second research hypothesis:

H_2: There is a significant relationship between board structure and bank performance.

5.3 Ownership Structure

Cole and Mehran (1998) find that changes in performance are significantly associated with changes in insider ownership. They document that the greater the increase in insider ownership, the greater the performance improvement, which is consistent with the alignment of interests hypothesis arising from a larger insider ownership. Also consistent with that hypothesis of Subrahmanyam et al (1997) who find evidence, in a sample of successful bidders in bank acquisitions, of a positive association between bidder returns and the level of insider ownership when the latter exceeds 6%.

Large shareholders and institutional investors can be seen as potential controllers of equity agency problems as their increased shareholdings can give them a stronger incentive to monitor firm performance and managerial behavior (Demsetz, 1983; Demsetz and Lehn 1985; and Shleifer and Vishny, 1986; Shleifer and Vishny, 1997, La Porta et al, 1998; La Porta et al, 1999; Claessens et al, 2000, and Denis and McConnell, 2003). This potentially helps to circumvent the free rider-problem associated with ownership dispersion.

Equity agency costs can be reduced by increasing the level of managers' stock ownership, which may permit a better alignment of their interests with those of shareholders. In fact, in the extreme case where the manager's share ownership is 100%, equity agency costs are reduced to zero (Jensen and Meckling, 1976). As managerial ownership increases, managers bear a large fraction of the costs of shirking, perquisite consumption and other value-destroying actions. Further, larger share ownership by managers reduces the problem of different horizons between shareholders and managers if share prices adjust rapidly to changes in firm's intrinsic value.

A limitation, however, of this mechanism as a tool for reducing agency costs is that managers may not be willing to increase their ownership of the firm because of constraints on their personal wealth. Additionally, personal risk aversion also limits the extension of this monitoring device as the allocation of a large portion of the manager's wealth to a single firm is likely to translate into a badly diversified portfolio (Beck and Zorn, 1982).

In accordance with the proposition that larger managerial ownership reduce agency costs, Kaplan (1989) finds that following large management buyouts, firms experience significant improvements in operating performance. He interprets this evidence as suggesting that operating changes were due to improved management incentives instead of layoffs or managerial exploitation of shareholders through inside information. Smith (1990) reports similar results and notes that the amelioration observed in operating performance is not due to reductions in discretionary expenditures such as research and development, advertising, maintenance or property, plant and equipment. Macus (2008) argues that the basic issue from an agency perspective is how to avoid such opportunistic behaviour. Previous studies suggest that corporate governance is an effective tool to control the opportunistic behaviour of management (Denis and McConnell, 2003; Bhagat and Bolton, 2008; Chen et al., 2009).

Research by Morck et al (1988), McConnell and Servaes (1990) and Hermalin and Weisbach (1991) is also consistent with the view that insider ownership can be an effective tool in reducing agency costs, although they report a non- monotonic relation. This functional form has been related to the observation that, within a certain ownership range, managers may use their equity position to entrench themselves against any disciplining attempts from other monitoring mechanisms. Spong and Sullivan (2007) reveal that boards of directors are likely to have a more positive effect on community bank performance when directors have a significant financial interest in the bank. However, some other studies find no evidence of a positive relationship between insider ownership and performance (see, for instance,

Demsetz and Lehn, 1985; Loderer and Sheehan, 1989; Holderness and Sheehan, 1988; Denis and Denis, 1994; and Loderer and Martin, 1997).

A possible explanation for these mixed results is that many of the studies do not properly distinguish the possibility of alignment of interests across a certain range of ownership values and of entrenchment over another range. Furthermore, these analyses usually do not take into account the possibility that several different mechanisms for alignment of interests can be used simultaneously, with substitution effects with insider ownership. It is quite conceivable that different firms may use different mixes of corporate governance devices (Rediker and Seth, 1995). These different mixes can, however, all be optimal as a result of varying marginal costs and benefits of the several monitoring instruments available for each firm. If so, then one would not be able to observe a relationship between performance and any of these particular mechanisms.
It appears that the main conflict is between owners and managers in common law countries due to the existence of dispersed control and ownership structures. While, in civil law countries the control and ownership structures are concentrated, thus the main governance problem arises between minority and controlling shareholders. Therefore, ownership structure has greater importance in civil law countries where protection of shareholders right is weak (La Porta et al., 1998; Beck et al., 2003). The situation is more prevalent in developing countries where large concentration of ownership is more evident while the stock markets are weak. In those countries there is a higher degree of economic uncertainties coupled with weak legal controls and investor protection, and frequent government intervention; all resulting in poor performance (Ahunwan, 2002; Rabelo and Vasconcelos, 2002; Tsamenyi et al; 2007).

Similar results are prevalent in the banking sector in the GCC countries where most ownership and control in substantial family corporate holdings and boards of directors are largely dominated by controlling shareholders, their friends and relatives. There are few independent directors on boards and shareholders dominate the decision-making process as there is rarely any separation between ownership and management. In most cases the chairman of the board is also the CEO; and there is a general lack of transparency and disclosure which leads to the conclusion that a high concentration of corporate ownership undermines the principles of good corporate governance (The Union of Arab Banks, 2003; Yasin and Shehab, 2004). Based on the above discussion, the third research hypothesis is:

H_3: There is a significant relationship between ownership structure and bank performance.

3. Research Methodology

3.1 The method

In order to test the hypotheses, quantitative method is used to investigate the effects of corporate governance mechanisms on bank performance. CG mechanisms include (ownership concentration, director ownership, duality, board size, board non-executives, board activism, audit committee and audit committee meetings), and other control variables, such as bank size, age and type of banks. The bank performance is measured by Tobin's Q, ROA, and Profit Margin. Bankscope database is used to select the country, Yemen and six GCC countries, and selected the top fifty banks from the above seven countries, as shown in table (1). It is also used the respective banks' websites and other websites to extract the relevant financial and non-financial information about each bank from its published audited financial statements, annual reports, and other relevant information.

3.2 Sampling and data collection

The sample includes conventional and Islamic banks operating in Yemen and the six GCC countries using the data for the year 2011. Excluded from the sample are banks that do not have audited financial statements. Financing, insurance, or non-bank institutions are excluded since they are different from banks with respect to their specific characteristics, management structures, accounting procedures, and audit functions. Table (1) below shows the population and samples selected per country.

The final sample consists of the largest 50 conventional and Islamic banks operating in Yemen and the six GCC countries. The process of selecting this sample is based on the values of these banks' total assets and the consequent ranking stated by Bankscope database. Any bank excluded due to any of the above reasons has been replaced with the next immediate bank in ranking. Table (2) summarizes the sample selection.

3.3 Measurement of variables

For bank performance measurement, the dependent variables used are Tobin's Q, ROA, and Profit Margin. Meanwhile, the independent variables used in regard to corporate governance mechanisms are ownership concentration, director ownership, duality, board size, board non executive, board activism, audit committee and audit committee meetings. Other control variables include bank type, bank age, and bank size. Table (3) shows the definition and measurement of these variables.

Table 1. Population and samples per country

Country	Population* (Banks only)	Sample Size	Sample Size (%)
Bahrain	29	14	48%
Kuwait	10	7	70%
Oman	7	7	100%
Qatar	7	7	100%
Saudi Arabia	12	9	75%
United Arab Emirates	19	7	37%
Yemen	11	8	73%
Total	95	59	62%

**Information from Bankscope Database*

Table 2. Sample selection

Number of banks selected from Bankscope Database based on its ranking for 2011 and the number of banks in each country	59
No annual reports available for 2011	(3)
No sufficient data about bank	(6)
Final sample Final sample (%)	50 53%

Table 3. Definition and measurement of variables

Variable Symbol	Definition	Measurement
Dependent Variables		
TobinQ	Tobin's Q	MVE + PS + Debt / TA (as per Chung and Pruitt, 1994)
ROA	Return on Assets	Net Income / Total Assets
PM	Profit Margin	Net Income / Revenues
Independent Variables		
OwnCon	Ownership Concentration	Adding up all shareholding of 5% or more
DirOwn	Director Ownership	Director ownership = 1; otherwise = 0
Brdsize	Board Size	Total number of board members during 2011
Duality	CEO Duality	If the CEO and Chairman are the same person = 0; otherwise = 1
BrdNonEx	Number of Non-Executives on Board	Number of non-executive members on the board during 2011
BrdActivism	Board Activism	Number of board meetings held during 2011
AC	Audit Committee	If Audit Committee exists = 1; otherwise = 0
ACmeetings	Number of Audit Committee Meetings per Year	Number of audit committee meetings during 2011
Control Variables		
TYPE	Bank Type	Conventional bank = 1; Islamic = 0
AGE	Age of Bank	In years: 10 or more = 1; less than 10 = 0
SIZE	Bank Size	Natural log of total assets

4. Data Analysis and Discussion

4.1 Descriptive Analysis

Table (4) illustrates the minimum and maximum values for the variables. The descriptive findings show the central tendency and dispersion of the indicators as shown in table (4). The study focuses on conventional and Islamic banks operating in Yemen and the six GCC countries.

Table (5) shows the frequency of the banks based on the GCC countries and Yemen.

Figure (1) shows the description of the sample based on number of banks on the six GCC countries and Yemen.

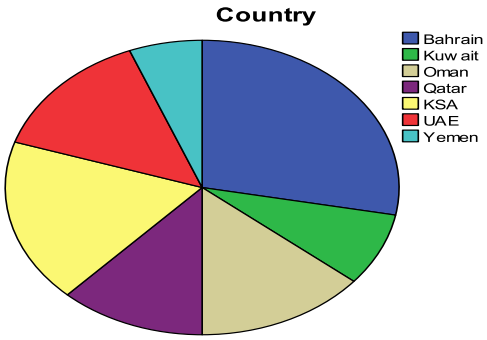
Table 4. Descriptive Statistics

Variables	Minimum	Maximum	Mean	Std. Deviation
OwnCon	0.05	1.0000	.62	.28
DirOwn	.00	1.00	.16	.37
Duality	.00	1.00	.92	.27
Brdsize	6.00	19.00	9.48	2.22
BrdNonEx	4.00	13.00	8.46	2.04
BrdActivisim	.00	9.00	4.96	1.67
AC	.00	1.00	.86	.35
ACmeetings	.00	11.00	4.08	2.41
Age	4.00	75.00	29.74	15.45
Size	6.21	11.33	8.91	1.52
TobinQ	.1300	3.2600	.94	.38
ROA	-.0090	.0491	.02	.01
PM	-.3700	.7500	.37	.22

Table 5. Frequency of the sample

Country	Frequency	Percent	Cumulative Percent
Bahrain	14	28.0	28.0
Kuwait	4	8.0	36.0
Oman	7	14.0	50.0
Qatar	6	12.0	62.0
KSA	9	18.0	80.0
UAE	7	14.0	94.0
Yemen	3	6.0	100.0
Total	50	100.0	

Figure 1. Description of the sample



4.2 Hypotheses Testing

For testing the first hypothesis, two-independent samples t-test is adopted. Finally, multiple regressions models are used to test the second and third hypotheses.

4.2.2 The difference between Islamic and conventional banks in using CG mechanisms

This hypothesis is concerned with the difference between CG practices in conventional and Islamic banks.

The two groups that are used in this hypothesis are: Islamic and conventional banks which use CG mechanisms. The independent-samples T-test is used to test this hypothesis as shown in table (6). For the ownership concentration as a CG mechanism, the interpretation of the independent t-test result is a two-stage process. The first stage is to examine the homogeneity of the variance between the two groups using *Levene's Test for Equality of Variances*, where (F = 8.953, P = 0.004). This is considerably less than 0.01 (thus significant), indicating that equal variances cannot be assumed. The second stage is to use the t-test row of results labelled equal variance not assumed. This provides the t-value (t = -.420), the degree of freedom (df = 16.186), and the sig. (2-

tailed) is .680, where (P > 0.05). Thus, the result is not significant which means that Islamic banks are not significantly different from conventional banks in using CG mechanism as in table (6).

For the other CG mechanisms (director ownership, duality, board size, board non-executives, board activism, audit committee and audit committee meetings), the interpretation of the independent t-test result is a two-stage process. The first stage is to examine the homogeneity of the variance between the two groups using Levene's Test for Equality of Variances, where (P-value for F-test > 0.05). This is considerably less than 0.05 (thus not significant), indicating that equal variances can be assumed. The second stage is to use the t-test row of results labelled equal variance assumed. Where (P-value for T-test > 0.05) for director ownership, duality, board non-executives, board activism, audit committee and audit committee meetings. Thus, the result is not significant except for board size where (P-value for T-test < 0.05) which means that there is a significant difference. Finally, it can be said that Islamic banks are not significantly different from conventional banks in using CG mechanism except for board size as in table (6). The results agree to great extent with the findings of Al-Tamimi (2012) that there is no significant difference between the UAE national conventional and Islamic banks regarding CG practices.

Table 6. Independent-Samples T-test

		F	Sig.	t	df	Sig. (2-tailed)
OwnCon	Equal variances assumed	8.953	.004	-.501	48	.618
	Equal variances not assumed			-.420	16.186	.680
DirOwn	Equal variances assumed	2.286	.137	.798	48	.429
	Equal variances not assumed			.712	17.563	.486
Duality	Equal variances assumed	.009	.926	.047	48	.963
	Equal variances not assumed			.047	21.006	.963
Brdsize	Equal variances assumed	.007	.932	2.563	48	.014
	Equal variances not assumed			2.163	16.330	.046
BrdNonEx	Equal variances assumed	.091	.764	.316	48	.753
	Equal variances not assumed			.294	18.675	.772
BrdActivisim	Equal variances assumed	.044	.835	-.865	48	.391
	Equal variances not assumed			-.807	18.749	.430
AC	Equal variances assumed	.105	.747	-.164	48	.870
	Equal variances not assumed			-.158	19.670	.876
ACmeetings	Equal variances assumed	.761	.387	-.402	48	.689
	Equal variances not assumed			-.356	17.335	.726

4.2.3 Testing the effect CG mechanisms on firm performance

The second and third research hypotheses are concerned with studying the effect of CG mechanisms on firm performance.

Three equations are used to test these hypotheses are presented in the formulars 1, 2, 3.

This hypothesis concerns with investigating the effect of firm size, firm age, and CG variables on firm performance by using OLS analysis. Table (7) provides the results for the multivariate regression models.

$$Tobin's\ Q = \alpha + \beta_1 OwnCon + \beta_2 DirOwn + \beta_3 Duality + \beta_4 Brdsize + \beta_5 Brdnonex + \beta_6 Brdativism + \beta_7 Ac + \beta_8 Acmeeting + \beta_9 Age + \beta_{10} Size + \varepsilon \quad (1)$$

$$ROA = \alpha + \beta_1 OwnCon + \beta_2 DirOwn + \beta_3 Duality + \beta_4 Brdsize + \beta_5 Brdnonex + \beta_6 Brdativism + \beta_7 Ac + \beta_8 Acmeeting + \beta_9 Age + \beta_{10} Size + \varepsilon \quad (2)$$

$$PM = \alpha + \beta_1 OwnCon + \beta_2 DirOwn + \beta_3 Duality + \beta_4 Brdsize + \beta_5 Brdnonex + \beta_6 Brdativism + \beta_7 Ac + \beta_8 Acmeeting + \beta_9 Age + \beta_{10} Size + \varepsilon \quad (3)$$

Table 7. OLS regression results

	Model 1 (Dependent Variable Tobin Q)		Model 2 (Dependent Variable ROA)		Model 3 (Dependent Variable PM)	
	Coeff.	t-statistics	Coeff.	t-statistics	Coeff.	t-statistics
Const.	.085	.153	.012	.720	.069	.205
Age	.006	1.765*	.000	1.098	.004	1.847*
Size	-.004	-.102	.000	-.220	.049	2.050**
OwnCon	-.120	-.649	-.011	-1.940*	-.156	-1.385
DirOwn	.114	.650	-.005	-.896	-.111	-1.047
Duality	-.040	-.149	-.007	-.884	-.214	-.317
BrdSize	.141	4.391***	.000	-.343	-.021	-1.051
BrdNonEx	-.103	-3.020***	.002	1.443	.009	.435
Brdactivism	.078	2.119**	.001	.567	.025	1.103
AC	.049	.239	.014	2.167**	.146	1.162
ACmeetings	-.023	-.716	-.002	-1.754*	-.016	-.825
F-statistics	3.508			2.345		2.853
p-value for F- test	0.002			0.028		0.009
R-squared	0.474			0.376		0.423
adjusted R^2	0.339			0.215		0.274
Max VIF	3.210			3.210		3.210

**Statistically significant at the 0.10 level*
*** Statistically significant at the 0.05 level*
**** Statistically significant at the 0.01 level*

Model 1 investigates the relationships between firm performance (Tobin's Q) and the variables of interest. The R^2 is 0.474 and the model appears highly significant (F = 3.508, p = 0.001). As regards our variables of interest, firm age, board size and board activism appear to have an effect on Tobin's Q, where the estimated coefficients are positive and statistically significant at 10%, 1% and 5% respectively. These results on board size are consistent with the results of Huang (2010) in Banks in Taiwan, however they are inconsistent with previous studies (Jensen 1993; Yermack 1996; Eisenberg et al, 1998; Singh and Davidson, 2003; Staikouras et al., 2007; Cheng, 2008). Board non-executives has an effect on Tobin's Q, where the estimated coefficient is negative and statistically significant at 1% level. This result is consistent with the finding of Agrawal and Knoeber (1996), Kochar and David (1996) and Bhagat and Black (2002). The variance inflation factor (VIF) score was calculated for each independent variable, in order to evaluate whether multicollinearity may be a cause of concern. VIF scores higher than 10 are likely to cause a multicollinearity problem (Gujarati, 2004). The highest VIF obtained is 3.210.

Regarding model 2, it examines the relationships between firm performance (ROA) and firm size, firm age, and CG variables. The R^2 is 0.376 and the model appears significant (F = 2.345, p = 0.028). As regards our variables of interest, audit committee appears to have an effect on ROA, where the estimated coefficients are positive and statistically significant at 5% level. Ownership concentration and audit committee meetings have an effect on ROA, where the estimated coefficient is negative and statistically significant at 10% level. These results are consistent with previous studies (Ahunwan, 2002; Rabelo and Vasconcelos, 2002; Tsamenyi et al; 2007). It seems that in GCC banks most ownership and control are in substantial family holdings and boards of directors are largely dominated by controlling shareholders. Thus the effect of the weak professional control results in poor performance. The highest VIF obtained is 3.210.

Regarding model 3, it examines the relationships between profit margin (PM) and firm size, firm age, and CG variables. The R^2 is 0.423 and the model appears significant (F = 2.853, p = 0.009). As regards our variables of interest, only firm age and firm size appear to have an effect on PM, where the estimated coefficients are positive and statistically significant at 10% and 5% level respectively. The results are consistent with the findings of Klapper and Love (2004) and Odegaard and Bohren (2003). This result may reflect an independent source of value creation, possibly due to market power and economies of scale and scope (Odegaard and Bohren, 2003). Moreover, large banks in the Middle East have more resources (e.g., more skilled managers) compared to medium and small banks which may help them to be more efficient and attract more investors and increase their firms' values. The highest VIF obtained is 3.210.

5. Summary and conclusion

This paper investigates the effect of corporate governance mechanisms on bank financial performance in seven Middle Eastern countries. The paper provides an insight into the corporate governance practices in 50 conventional and Islamic banks operating in Yemen and the six GCC countries and the effect of such practices on Tobin's Q, ROA and PM. Corporate governance of banks in emerging economies is of crucial importance as banks hold an overwhelmingly dominant position in the financial systems of these countries. Moreover, banks are extremely important engines of growth in such countries as they are typically the most important source of finance for the majority of firms, in addition to playing a major role in the payment & saving system. Therefore, bank governance is of crucial importance as the reduced role of economic regulation has resulted in the managers of banks having greater freedom on how they run their banks.

Emerging economies are likely to require more effective and stronger governance mechanisms than their western developed counterparts if they are to become equal, full, and active participants in the global financial marketplace. The governments of most GCC countries have taken the necessary actions to have a strong financial sector based on well-established financial companies, in order to keep pace with international developments and enable the vision of a solid economy that will be recognized internationally. While the corporate governance codes and regulations in the GCC might not be as elaborate as corporate governance regimes in western countries, they can be said to provide adequate coverage of the key disclosure issues of relevance in a market with a nascent disclosure culture. Nonetheless, policy makers in GCC countries need to ensure that firms implement effective corporate governance mechanisms. This implementation should be appropriate for the GCC business environment while embracing international corporate governance standards.

The results reveal that certain corporate governance mechanisms have impact on market value performance. Meanwhile, book value performance is affected by different corporate governance mechanisms. The study results are consistent with previous literature that the correlation between corporate governance and performance is still not clearly established and that financial impact on corporate governance on performance in emerging economies is still relatively scarce. The results reveal that corporate governance practices do not differ between conventional and Islamic banks in the Middle East.

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Appendix 1. List of Banks

	Bahrain:	Kuwait:	Oman:	Qatar:	Saudi Arabia:	UAE:	Yemen:
1	Ahli United Bank BSC	National Bank of Kuwait S.A.K.	Bank Muscat SAOG	Qatar National Bank	National Commercial Bank (The)	Emirates NBD PJSC	Tadhamon International Islamic Bank
2	Albaraka Banking Group B.S.C.	Al Ahli Bank of Kuwait (KSC)	National Bank of Oman (SAOG)	Commercial Bank of Qatar (The) QSC	Al Rajhi Banking & Investment Corporation-Al Rajhi Bank	Natiional Bank of Abu Dhabi	Yemen Bank for Reconstruction and Development
3	Gulf International Bank BSC	Jordan Kuwait Bank	Bank Dhofar SAOG	International Bank of Qatar Q.S.C.	Riyad Bank	Abu Dhabi Commercial Bank	National Bank of Yemen
4	BBK B.S.C.	Industrial Bank of Kuwait K.S.C.	Bank Sohar SAOG	Qatar International Islamic Bank	Banque Saudi Fransi	First Gulf Bank	
5	Ithmaar Bank B.S.C.		HSBC Bank Oman	Qatar Development Bank Q.S.C.C.	Saudi British Bank (The)	Dubai Islamic Bank plc	
6	National Bank of Bahrain		Oman Arab Bank SAOG	Qatar First Investment Bank	Arab National Bank	Union National Bank	
7	Al-Baraka Islamic Bank		Ahli Bank SAOG		Islamic Development Bank	Mashreqbank	
8	Arcapita Bank				Saudi Hollandi Bank		
9	Al-Salam Bank Bahrain				Bank Al-Jazira		
10	Investcorp. Bank						
11	Bahrain Islamic Bank						
12	United Gulf Bank						
13	BMI Bank						
14	Future Bank						