Faculty of Economics and Business

The Impact of Corporate Governance on Banking Financial Performance: A Comparative Analysis of the United Arab Emirates (UAE) and the Middle East and North Africa Region (MENA)

Amjed Ahmed Mohammed

Doctor of Philosophy
2024

The Impact of Corporate Governance on Banking Financial Performance: A Comparative Analysis of the United Arab Emirates (UAE) and the Middle East and North Africa Region (MENA)

Amjed Ahmed Mohammed

A thesis submitted

In fulfillment of the requirements for the degree of Doctor of Philosophy

(Finance & Accounting)

Faculty of Economics and Business
UNIVERSITI MALAYSIA SARAWAK
2024

DECLARATION

I declare that the work in this thesis was carried out in accordance with the regulations of Universiti Malaysia Sarawak. Except where due acknowledgements have been made, the work is that of the author alone. The thesis has not been accepted for any degree and is not concurrently submitted in candidature of any other degree.

……………………………

Signature

Name: Amjed A. Mohammed

Matric No.: 16010100

Faculty of Economics and Business

Universiti Malaysia Sarawak

Date :

ABSTRACT

The examination of corporate governance emerges as a critical discourse in the backdrop of significant global economic crises, such as the OPEC oil price shock in 1973, the Asian crisis in 1997, and the World financial crisis in 2008. The Middle East and North Africa (MENA) region, particularly impacted by various economic challenges, including fluctuating oil prices and global financial crises, witnessed pivotal moments in 1998, 2008, and 2014, according to the World Bank and the Institute of International Finance. Despite these challenges, certain countries in the MENA region, notably the United Arab Emirates (UAE), have demonstrated resilience and sustained economic growth, attributed to effective policies in infrastructure, tourism, logistics, and trade. The UAE, in particular, stands out for its remarkable economic diversity and high growth rates, fostered by a stable political and economic environment. However, the MENA region, including the UAE, faces corporate governance disparities, as not all nations align with the four thematic areas proposed by the Organisation for Economic Cooperation and Development (OECD). While the corporate governance initiative for 2016-2020 aimed at improving transparency and disclosure, achieving gender balance in corporate leadership, and enhancing state-owned enterprises (SOEs), a critical need exists to assess its impact, especially on financial institutions in the UAE and other MENA countries. This study focuses on comparing the performance of banks in the UAE and the broader MENA region, exploring the relationship between corporate governance and bank performance. It seeks to ascertain whether UAE banks employ a more effective corporate governance mechanism than their counterparts in the MENA region and aims to comprehend corporate governance issues in the MENA region. Key areas of investigation include ownership patterns, accountability mechanisms, reporting methods, and the application of corporate governance principles. Employing various theories such as agency theory, stewardship theory, resource dependency theory, and stakeholder theory, this study delves into corporate governance practices, emphasizing critical performance indicators like Tobin's Q (TBQ), Return on Equity (ROE), and Return on Total Assets (ROTA). This study employs a robust research methodology, including a Dynamic Panel Data Model (DPD) with Generalized Method of Moments and regression analysis, spanning both static and dynamic dimensions. The dynamic analysis reveals a significant positive impact of corporate governance on UAE banks' market capitalizations (TBQ), while static analysis in the MENA region indicates an insignificant impact on market capitalizations (TBQ) and leverage (lev). ROE in the MENA region exhibits a consistently positive and significant impact. In conclusion, this study suggests that UAE banks demonstrate a more effective corporate governance mechanism than those in the broader MENA region, contributing to the UAE's attractiveness for investments due to strong government laws and policies promoting economic growth and stability. UAE's openness to foreign investments and initiatives to attract skilled expertise further solidify its position as an investment hub in the MENA region.

Keywords: Corporate governance, bank performance, corporate governance mechanisms, Tobin's Q, MENA and UAE banks

Kesan Tatakelola Korporat ke atas Prestasi Kewangan Perbankan: Analisis Perbandingan antara Emiriah Arab Bersatu (UAE) dan Kawasan Timur Tengah dan Afrika Utara (MENA)

ABSTRAK

Pemeriksaan tadbir urus korporat muncul sebagai perbincangan penting dalam konteks krisis ekonomi global yang signifikan, seperti kejutan harga minyak OPEC pada tahun 1973, krisis Asia pada tahun 1997, dan krisis kewangan dunia pada tahun 2008. Kawasan Timur Tengah dan Afrika Utara (MENA), terutamanya terjejas oleh pelbagai cabaran ekonomi, termasuk fluktuasi harga minyak dan krisis kewangan global, menyaksikan momen penting pada tahun 1998, 2008, dan 2014, menurut Bank Dunia dan Institut Kewangan Antarabangsa. Walaupun menghadapi cabaran ini, beberapa negara di rantau MENA, khususnya Emiriah Arab Bersatu (UAE), telah menunjukkan ketahanan dan pertumbuhan ekonomi berterusan, yang dikaitkan dengan dasar-dasar yang berkesan dalam infrastruktur, pelancongan, logistik, dan perdagangan. UAE, khususnya, menonjol dengan kepelbagaian ekonomi yang luar biasa dan kadar pertumbuhan tinggi, yang dipupuk oleh persekitaran politik dan ekonomi yang stabil. Namun, rantau MENA, termasuk UAE, menghadapi perbezaan tadbir urus korporat, kerana tidak semua negara sejajar dengan empat bidang tematik yang dicadangkan oleh Pertubuhan Kerjasama dan Pembangunan Ekonomi (OECD). Manakala inisiatif tadbir urus korporat untuk tahun 2016-2020 bertujuan untuk meningkatkan ketelusan dan pendedahan, mencapai imbangan gender dalam kepimpinan korporat, dan meningkatkan syarikat milik kerajaan (SOE), keperluan kritis wujud untuk menilai kesannya, terutama terhadap institusi kewangan di UAE dan negara MENA lain. Kajian ini memberi tumpuan kepada perbandingan prestasi bank di UAE dan rantau MENA secara keseluruhannya, mengeksplorasi hubungan antara tadbir urus korporat dan prestasi bank. Ia bertujuan untuk menentukan sama ada bank-bank UAE menggunakan mekanisme *tadbir urus korporat yang lebih berkesan daripada rakan-rakan sejawat mereka di rantau MENA dan bertujuan memahami isu tadbir urus korporat di rantau MENA. Bidang kajian utama termasuk corak kepemilikan, mekanisme tanggungjawab, kaedah pelaporan, dan aplikasi prinsip tadbir urus korporat. Dengan menggunakan pelbagai teori seperti teori agensi, teori penjagaan, teori ketergantungan sumber, dan teori pihak berkepentingan, kajian ini menyelidiki amalan tadbir urus korporat, menekankan penunjuk prestasi penting seperti Tobin's Q (TBQ), Pulangan Ekuiti (ROE), dan Pulangan Jumlah Aset (ROTA). Kajian ini menggunakan metodologi penyelidikan yang kukuh, termasuk Model Data Panel Dinamik (DPD) dengan Kaedah Amalan Umum dan analisis regresi, merangkumi dimensi statik dan dinamik. Analisis dinamik menunjukkan impak positif yang signifikan tadbir urus korporat ke atas kapitalisasi pasaran bank di UAE (TBQ), sementara analisis statik di rantau MENA menunjukkan impak tidak signifikan ke atas kapitalisasi pasaran (TBQ) dan leverage (lev). ROE di rantau MENA menunjukkan impak positif dan signifikan secara konsisten. Kesimpulannya, kajian ini mencadangkan bahawa bank-bank UAE menunjukkan mekanisme tadbir urus korporat yang lebih berkesan berbanding dengan rakan sejawat mereka di rantau MENA secara keseluruhan, menyumbang kepada daya tarikan UAE sebagai destinasi pelaburan disokong oleh undang-undang kerajaan yang kukuh dan dasar-dasar yang mempromosikan pertumbuhan ekonomi dan kestabilan. Keterbukaan UAE terhadap pelaburan asing dan inisiatif untuk menarik kepakaran mahir dan pelaburan langsung asing telah memperkuat kedudukannya sebagai pusat pelaburan utama di rantau MENA.*

Kata kunci: *Tadbir Urus Korporat, prestasi bank, mekanisme tadbir urus korporat, Tobin's Q, MENA dan bank UAE*

TABLE OF CONTENTS

LIST OF TABLES

LIST OF FIGURES

CHAPTER 1

INTRODUCTION

1.1 Introduction

In corporate governance, it is the responsibility of investors to appoint auditors and managers to ensure that the auditors and managers are performing their role in an appropriate manner. On the other side, the responsibility of the auditor is to evaluate the financial situation of the organization (Rodriguez-Fernandez, 2016).

Corporate governance refers to the practice for establishing, leading and controlling the organization (Berger et al., 2016). This system is planned to effectively lead the organization relied on the principles of good corporate governance. Principles of good corporate governance consider many factors such as independence, fairness, transparency, accountability, and responsibility. Parties, which are considered in the management system of the organization named employees, creditors, shareholders, government, and investors that effectively encourage the practice of the corporate governance. Performance of the organization would, be enhancing by the implementation of good corporate governance. Execution of good corporate governance assists to enhance the value for investors and shareholders (Hassan et al., 2015).

Directors are selected to maintain and succeed in the business of the organization. Directors are accountable to secure the benefits of investors because shareholders are the owners of the organization. The main cause of focusing on corporate governance is to resolve the agency issue. Managers, who are working in the corporate system, have more authority and information than shareholders. The main aim of the shareholders is to obtain a profit as a bonus on their investment whereas the managers could have a slightly different aim from the shareholders such as managers want to protect their job and likes to get a promotion. Corporate governance is very imperative due to its worldwide significance for the corporate leading organization, research scholars, and medical practitioners. For example, Enron and WorldCom encouraged the interest of globe with respect to need by introducing the mechanism of governance; furthermore, Sarbanes-Oxley act as a phase with respect to making sure the transparency and reliable disclosure of financial issues of the company (Francis et al., 2015).

There are different methods for measuring the performance of finance; however, all measurements can be taken in the accumulations. Metrics such as operating income, operations, and cash flow from operations are commonly utilized, along with total unit revenues. Moreover, the investor can wish for looking deeper into the financial statements and looking for margin growth rates and reducing debt. There are a different private institutions and state companies that has corporate governance system and processes in place to make sure that governance practices are significant (Aguilera et al., 2015).

In the analysis of the performance of both private and public sector companies, it becomes evident that these organizations showcase a commendable level of accountability and transparency to various stakeholders. The companies diligently adhere to legal and regulatory requirements, ensuring that all necessary data is disclosed to the concerned parties. Furthermore, these companies exhibit a proactive approach in monitoring and mitigating risks while fostering innovation and adaptability. Their strategic focus remains grounded in legitimacy, relevance, and competitiveness, ultimately driving them towards financial stability and sustainability (Miglani et al., 2015).

The absenteeism of measuring the profit in the public sector makes an assessment and evaluates the performance of management more difficult in profit-oriented companies. Under the public sector, different elements are practiced for determining the performance. Furthermore, the economy is to be determined by the association between the quality and quantity of resources and its associated expenses. It is also determined that efficiency is to be measured by the association amid resources input and outputs. Along with this, the effectiveness could be measured by the degree that helps to attain the set outcomes and feasibility could be determined by the degree of the program. Thus, it is the preference of government and addresses the real requirements of the economy (Pletzer, et al., 2015).

Corporate governance and financial performance have certain difficulties that relate with complexity to measure and thus, there is a need for assessing the principals and problem associated with the agent. There are no simple techniques for measuring the profitability in State Corporation. The issue in the public sector is addressed while the principal unable to specify the enough transparency regarding what interest to be pursued and how the agent is supposed for attaining them. It also helps to determine the cost of poor state corporate governance. For illustration, governments and their bureaucracies generate provisional monopoly power. It generates the opportunity for corruption in state companies that have been discussed as one of the poor state governances (Iraya et al., 2015).

Corporate governance is an imperative problem for the bank's management that could be evaluated by a different dimension. Moreover, corporate function transparency is one major factor that creates a major issue for protecting the interest of investors. Apart from this, corporate governance is evaluated that a sound risk management system is another major issue for the organization. In addition, previous studies also evaluated that the corporate governance decides the method in which the organization is controlled by the senior management team and directors. The team member could focus on getting higher competitive benefits in the least time and cost. These team members could maintain day to day activity and expectation of the business to obtain objectives and aim of the organization. Corporate governance leads the financial institution to manage compliance and with reliable regulations and laws and control the depositor's interest and will also be effective for getting a reliable outcome with respect to the current issues. In the current era, application of technology has been increased that made the financial institution freer and more open to new goods and services in the financial structure.

Beside this, previous studies prove that these changes could directly impact on the financial structure as it would create an issue for the organization to improve the operating system. In addition, Ana Paula (2017) has also examined that weak corporate governance could create a weak internal system that could be failed to manage fraudulent practices, whereas inadequate supervision and monitoring of financial organizations to confirm the compliance with the requirements of corporate governance precipitated and caused of banking crisis. Further, as per Bank for international settlements (2005) it is also analyzed that annoying feature in the controlling team of banking operation could directly influence the overall financial performance of the firm.

Goergen (2012) identified that corporate governance has several benefits for all stakeholders especially the company or business entity implementing the effective practices and theories of corporate governance. Corporate governance goes a long way to promote a good brand and corporate image for companies. Publicly declaring the corporate governance policies and how they are implemented puts confidence in all stakeholders. This also aids in attracting prospective and profitable investors and customers who can patronize the products manufactured and services delivered by the company (Denis & McConnell, 2003). Effective practice of transparency in relation to information sharing boosts confidence of stakeholders.

Clarke and Dela Rama (2008) identified that corporate governance tends to help streamline the operations of companies and corporate bodies to ensure that they comply with rules, regulations and laws within their operational areas. In areas of decision making, rules and regulations about the industry in which they operate must be adhered to. In view of this, waste of resources on arising legal issues which occur due to the flouting of the rules and regulations can be curtailed. Crawford (2007) explained that effective corporate governance helps reduce operational cost.

According to Bowen (2004), effective implementation of corporate governance promotes growth and development through the reduction of arising conflicts between stakeholders. Corporate governance helps the formulation of policies, rules and regulations that ensures that all internal stakeholders such as shareholders, employees, management team members and board of directors abide by them to ensure smooth operations.

Clarke (2007) explained that fraudulent activities can be checked through the implementation of corporate governance practices. As identified by Sun (2009), fraud through accounting has been a common device fingered to be the cause of several corporate scandals. This tends to safeguard the financial investments of shareholders as well as protect and ensure employee job security. Ensuring transparency also enables corporate bodies to make available credible and accurate information that helps in decision making process of all stakeholders.

The banking industry is an important industry in every economy especially in the areas of providing funds and managing it as well for its risk management of assets. Khalid (2011) explained that financial and accounting fraud has been the main tool causing scandals among corporate bodies globally. In view of this, there is the need for the financial industry especially banks to ensure that corporate governance is well implemented to ensure that funds are always safe and readily available. Hassen (2008) explained that risk management is an integral part of the operations of financial companies. Risk management and diversification can be properly achieved through the implementation of effective corporate governance practices.

In the bid to manage the country's currency; formulate and implement monetary policy; and regulate the banking industry in the United Arab Emirates, the Central Bank of the country was established by Law No (10) of 1980 (Safi, 2012). The Central Bank is expected to provide licensing and regulation for commercial banks and investment banks and companies. The financial intermediaries such as the investment banks and companies are expected to manage portfolios of individuals and companies; provide professional advice to its customers on issues of equity and debt; subscription to debt and equity instruments; develop financial related research and feasibility studies for projects; manage market share and debt instruments; as well as establish and manage funds. Financial and monetary intermediaries have the responsibilities of brokering the purchase and sale of domestic and foreign instruments well as the foreign exchange dealers who purchase and sell currencies respectively (Khan & Walker, 2015). With an improvement in stability in the geo – political terrain of the United Arab Emirates, which has resulted in the unification of the seven Emirates, Foreign Direct Investments (FDIs) is an effective tool that can be considered to ensure the growth and development of the unified Emirates (Zawya, 2016). According to the

United Arab Emirates Country brief (2016), the country provides a unique environment for Foreign Direct Investments in the bid to increase its per capita. With a unique strategy of economic diversification that ensures changes and significant improvement to its economic sectors such as infrastructure; financial services; tourism; and education (Schneidhofer, 2016). The United Arab Emirates has currently joined the top 10 host economies with $11 billion in 2016 (World Investment Report, 2016) and even UAE maintains to be in the top 10 host economies with $20 billion in 2021 (World Investment Report, 2021). The below statistics shows the FDI inflows (2016 and 2021) where UAE falls in the top 10 list however none of the countries from the MENA region compete in the list.

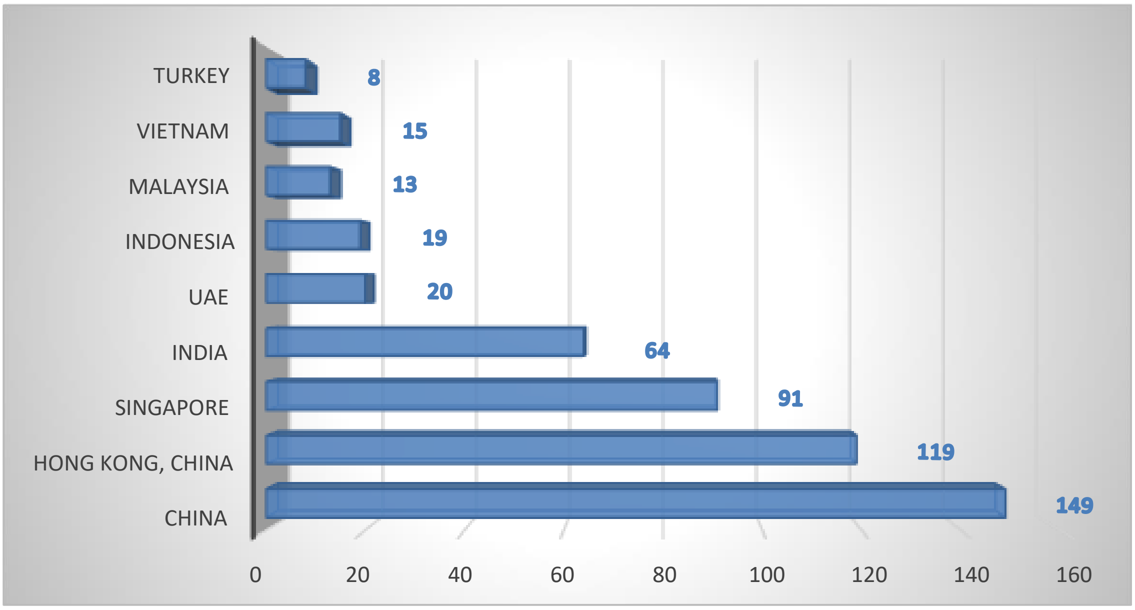

Figure 1.1: Developing Asia FDI inflows 2021

Source: World Investment Report (2021); United Nations Conference on Trade and Development (2021)

The graph represents the FDI inflows from the top 10 host economies in 2021, where UAE is in the top 10 list with 20 billion dollars of Foreign direct investments being the only country to compete from the MENA region. Reference period in this study is considered between 2016 – 2020 therefore the above graph is also representing the time frame considered in the research. According to Asefeso (2016), the United Arab Emirates has one of the fastest growing economies with a high level of diversification. In the bid to ensure economic growth and stability, the Dubai Economy (2017) outlined that there is a high level of economic and political stability. As a pro – business government, there are several economic policies that have been liberalized to attract a large level of Foreign Direct Investments. The country's laws ensure that there is copyright protection and intellectual property laws. Also, the free economic system allows a low level of government interference as well as promotes a low level of bureaucracy. A high level of tax exemptions on personal income and corporate profits contributes to making the country a viable option for Foreign Direct Investments (Marsh, 2015).

Infrastructural development is also high in the United Arab Emirates. The modernized infrastructure that promotes quality and efficient services for the friendly business environment also tends to promote efficient delivery of services in a long – term business relationship (United Arab Emirates Country Risk Report, 2017). A high level of flexibility is promoted through the infrastructural development that ensures the timely delivery services as well as a reduction in complications associated with logistics and a subsequent reduction in the cost of operation (Said, 2016).

In the wake of the increasing calls for greener environment and technology, the United Arab Emirates has taken a step in that direction to promote and strengthen its stand on reducing global warming. The technology and infrastructure in place promotes a green environment. According to Safi (2012), a diverse business environment promoted by the

United Arab Emirates ensures that climate change is checked through the manufacture of products and delivery of services by both local and foreign companies.

1.2 Background of the Study

The term corporate governance has been initiated since last two decades and not yet become fully predicted even through a high amount of literature is available on the research concern. This is illustrated in different mode by different authors. An organization for economic operation with development is illustrated as the set of association between the management of the company, its shareholders, other stakeholders, and the board of the company. It involves the rules and process to be applied by which company's objectives can be attained (Nobanee & Ellili, 2016). It is determined by the corporate governance technique can aid to attain the profitability and attain the company's objectives. Hence, the key characteristics of good corporate governance involve simple process, corporate structure, and accountability of managers and board of director with regards to stakeholders (Abdullah et al., 2015). The significance of corporate governance has become a serious concern after the failure of Enron and WorldCom; however, it cannot be assumed that aspect of corporate governance is new (Mohamed, 2016). This significance is initiated when the separation between the possession and management of the company took place.

OECD (Organization for Economic Cooperation and Developments) has presented corporate governance system in 1999. From that time, they are paying attention to a wide range of investors such as organization, stockholders, and policymakers. These strategies offer common values of the corporate governance system. Most of the European countries follow the corporate governance system in work from the establishment and at present their goodwill is growing faster than developing countries. For the determination of the relationship between the corporate governance system and its effect on the performance of the organization, several experimental works are completed in the developing countries (Mollah & Zaman, 2015). The efficiency of the corporate governance system has estimated by the majority of the research scholars of developing countries with the help of conventional detriments of corporate governance as these data could easily take out from the annual reports of the organization. Conventional detriments of corporate governance are the size of the board, the composition of the board, the responsibility of audit and other teams, concentration on ownership and duality of chief executive officer (CEO). Furthermore, the main objective of this study is to produce a perfect model by including conventional detriments, and other detriments of corporate governance such as it will the enhance the efficacy of corporate governance, and consequently, the performance of the organization would be increased (Zagorchev & Gao, 2015).

Corporate governance enables the organizations to promote probity, integrity, recognition, protection, and transparency of shareholders rights (De Haan & Vlahu, 2016). In addition, it is examined that good corporate governance will also concentrate on making effective as well as the efficient organization as it could contribute to the social welfare by developing wealth employment. Moreover, it is also examined that good corporate governance could be effective for making a reliable decision in the context of current research matter. Corporate governance makes an inclusive approach for an organization to effectively operate their business activity and get a reliable result (Gitman et al., 2015). This approach considers certain factors like legitimate representation, democratic ideals, and economic atmosphere as it permits the organization to flourish the firm by proceeding value of shareholder. Further, corporate governance will support to improve the activity of the human resource development team. They also lead to each activity of the shareholder to