



The influence of corporate governance on the performance of the United Arab Emirates and other banks in the Middle East and North Africa region: A comparative analysis

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Abstract

This study explores the impact of corporate governance (CG) on the performance of banks in the Middle East and North Africa (MENA) region, with a focus on the United Arab Emirates (UAE). The MENA region, characterized by diverse economic landscapes, is analysed through a comparative study encompassing 141 financial institutions across 12 countries from 2016 to 2020. Key performance indicators, such as Tobin's Q ratio (TBQ), Return on Equity (ROE), and Return on Total Assets (ROTA), are assessed in relation to CG mechanisms. The research employs principles components analysis (PCA) to delve into CG practices, covering board size, independence, diversification, meetings, remuneration, and ownership concentration. External factors such as GDP growth rate, bank size, and market capitalization are also considered. Findings indicate a stable relationship between CG and financial performance, emphasizing effective governance's significance. The UAE has emerged as a CG leader since 2007, boasting a legislative framework that strengthens practices. Disparities in CG standards across the MENA region are noted, with some countries relying on regulatory standards and others implementing comprehensive CG codes. The study highlights CG's positive impact on financial performance, particularly on ROE and ROTA, in the UAE and the broader MENA region. The UAE's robust CG mechanisms, recent regulatory changes, and investor-friendly policies make it attractive for investors. Economic factors, such as GDP growth rate and bank size, are also considered. Acknowledging limitations, such as reliance on historical data, the study suggests future research avenues, including exploring specific CG mechanisms contributing to performance improvement and investigating cultural and institutional factors' impact on governance practices.

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1. Introduction

The term "Middle East and North Africa (MENA) region" denotes a geographic expanse that includes nations located in both the Middle East and distinct portions of North Africa (Angrist, 2010). The MENA

region is widely acknowledged for its multifaceted attributes, encompassing cultural, historical, economic, and geopolitical aspects. The examination of the economic terrain in the MENA area is characterized by disparities in income distribution, endeavors to achieve economic diversification, and varying degrees of industrial progress (Alsharari, 2019). In order to substantiate this contention, it is evident that certain nations within the area exhibit strong economic performance, which can be attributed to thriving sectors such as finance, real estate, and tourism. Conversely, there are other countries that largely depend on the exportation of oil and the utilization of energy resources as their primary sources of economic sustenance (Makdisi, Fattah, & Limam, 2006).

Known for their distinct cultural, legal, and economic landscapes, the MENA regions are not exempt from the need to enhance their corporate governance (CG) frameworks to shape business practices and promote sustainable economic growth (Mertzanis, Basuony, & Mohamed, 2019; Piesse, Strange, & Toonsi, 2012). The acknowledgement of the significance of corporate governance in achieving economic prosperity has led to a prevailing inclination towards contemporary governance methodologies. Since corporate governance (CG) first emerged in 1990 as a result of a financial crisis, numerous multinational corporations have shifted their attention to CG practice (Morck & Steier, 2005). This shift was a response to various prominent corporate scandals and financial crises, culminating in the implementation of the Sarbanes-Oxley Act in 2004 (Gray & Ehoff Jr, 2015). The goal of CG is to implement stronger laws and reporting requirements for public firms in order to improve corporate governance initiatives. The establishment of the Principles of Corporate Governance by the Organisation for Economic Cooperation and Development (OECD) to provide an internationally recognized framework for sound governance practices (Jesover & Kirkpatrick, 2005) reinforces the underlying concept that CG must be more than just practices but a way of doing business.

Numerous scholars and researchers have explored the relationship between corporate governance and firm performance. Renneboog and Szilagyi (2008) investigated the relationship between corporate governance and business performance in several nations and discovered that better governance practises are associated with higher firm performance and valuation. To link to the banking industry, Haider, Khan, and Iqbal (2015) indicate a substantial positive relationship between corporate governance and the financial performance of Islamic banking sectors in emerging nations such as Pakistan. Another intriguing discovery discovered by Ali (2018) on a comparative analysis between the United States (a developed country) and Pakistan (a developing country) reveals mixed results due to the strictness (developed country) of following corporate governance codes compared to developing countries due to differences in controlling stakes in the business.

Directly assessing corporate governance can be difficult, but proxy metrics provide useful insights into an organization's governance architecture. These criteria are easily accessible and quantitative, allowing stakeholders to assess the effectiveness and integrity of governance systems. Notably, board independence is a significant proxy measure. A board of directors without conflicts of interest is an essential component of good corporate governance (Khan & Hussain, 2019). According to Sarhan and Al-Najjar (2022), executive compensation arrangements are also important as proxies for ensuring that executive remuneration matches corporate performance and shareholder interests. Furthermore, the appropriate board size (Kyeré & Ausloos, 2021) is a point of contention in the corporate governance environment. Another significant component is governance diversity, which includes a diverse range of backgrounds, skills, experiences, and opinions on the board (Sarhan, Ntim, & Al-najjar, 2018). Furthermore, Fahad and Rahman (2020) mentioned that board meetings are a vital component of governance because they provide a venue for directors to congregate, deliberate, and make critical decisions about the company's strategic direction and operations.

This paper seeks to compare corporate governance cognizance implementation across all MENA areas. The UAE is a remarkable example of a MENA country that has prioritized governance standards for publicly traded entities while paying varying amounts of attention to different business types since 2007 (Al-gamrh, Ku Ismail, Ahsan, & Alquihaf, 2020), being the first in the region. Its legislative framework, laws, securities and commodities, shareholders' rights, enforcement, and compliance have strengthened corporate governance practice. Other countries, however, continue to rely on regulatory standards, and some have comprehensive corporate governance codes that place emphasis on listed versus non-listed companies (Najib, 2007; Shehata, 2015). For example, Qatar, implemented the Qatar Financial Markets Authority (QFMA) in 2009 (Awadallah, 2020), with a focus on board structure, transparency, and disclosure for listed companies, while the Jordan Securities Commission (JSC) issued the Corporate Governance Code for Public Shareholding Companies in 2009 (Omar & Simon, 2011), highlighting governance practises related to board composition, transparency, and disclosure.

Additionally, there are variations in the ownership and power of the local governments. In spite of the fact that government agencies hold large stakes in a number of MENA countries' industries (Iraya, Mwangi, & Muchoki, 2015; Pletzer, Nikolova, Kedzior, & Voelpel, 2015), many of these companies are still mostly family-owned (Awadallah, 2020) which has a direct bearing on board composition and succession planning methods. The dynamics of good corporate governance, including how governments, corporations, and family-owned businesses operate, may be impacted by this occurrence.

Thus, this paper seeks to uncover the disparity in corporate governance practices between the other MENA regions and the UAE in banking industry. While the UAE is often regarded as a pioneering force in fostering robust corporate governance, there exists a noticeable gap when comparing its practices to those of

other MENA countries. The purposes of this study are (1) to understand how corporate governance affects the performance of MENA banks by comparing them with UAE banks, and (2) to investigate the efficacy of corporate governance in influencing the performance of banks in both the UAE and the MENA region. Following this introduction section, the second section presents a literature review for systematically reviewing and analyzing existing literature. The third section briefly discusses methodology and research design. A description of the dynamic model, data used, and empirical results and discussions are presented in the fourth section. The last section contains a summary and conclusions.

2. Literature Review

2.1. Background

Corporate governance (CG) refers to the set of norms, processes, practices, and organizational structures that shape the functioning of a firm. These elements are influenced by two prominent theoretical frameworks: Institutional Theory, as proposed by DiMaggio and Powell (1983); Meyer and Rowan (1977) and Scott (1976) Stakeholder Theory as proposed by Freeman, Harrison, Wicks, Parmar, and Colle De (1984). According to institutional theory, the larger institutional context which includes statutory frameworks, cultural norms, and industry conventions has an impact on corporate governance (CG). Various external influences have a significant impact on the design and implementation of corporate governance procedures within an organization. Furthermore, the Stakeholder Theory places significant emphasis on the necessity of taking into account the interests of many stakeholders in corporate governance procedures. The aforementioned entities encompass shareholders, employees, customers, suppliers, and the broader community. According to Stakeholder Theory, the objective of corporate governance (CG) is to achieve a harmonious equilibrium among the many interests involved, thereby guaranteeing that all stakeholders are given an opportunity to participate in decision-making procedures.

Several scholars have proposed ideas aimed at implementing effective governance practices in response to ongoing debates surrounding theoretical frameworks and the lack of clarity regarding the efficiency of governance processes in various nations (Khanchel, 2007; Mitchell, Packard, & Clark, 2023; Orbay & Yurtoglu, 2006). Numerous scholarly publications have been dedicated to the examination of governing methodologies (Mahmood, Kouser, Ali, Ahmad, & Salman, 2018; Prokhorova & Zakharova, 2016).

Gereffi, Humphrey, and Sturgeon (2005) identified two main sorts of governance systems in their study. The first category encompasses the external disciplinary mechanisms, which include various factors such as the possibility of takeovers, competition within the product market, the labor market for managerial roles, mutual supervision among managers, and security analysts, the legal system, and the impact of reputation. The second category pertains to internal control measures, which involve several factors such as the board of directors, insider ownership, pay packages, debt policy, dividend policy, substantial and institutional shareholders, and compensation packages.

The literature review on corporate governance in the banking sector highlights key themes and findings that underscore the importance of robust corporate governance practices. Notably, there is a positive correlation between strong corporate governance and financial performance. The role of board independence in decision-making is emphasized, emphasizing the need for boards composed of qualified and independent directors. Additionally, transparency and disclosure are identified as crucial elements, emphasizing the importance of banks being transparent about their financial performance and risks to various stakeholders. Effective risk management systems are considered essential, with a call for regular reviews and updates to ensure their efficacy (Suliman & Elbannan, 2020). This literature provides valuable insights into the intricate relationship between corporate governance, financial performance, and risk management in the banking sector, setting a foundation for further research in the context of UAE.

Finance companies are integral components of the financial systems in both developed and developing countries, facilitating support for a diverse range of enterprises. Their presence fosters competition within the financial services industry and provides numerous alternatives for converting economic savings into capital creation. Despite their significance, the total assets of finance companies operating in the UAE represent a relatively small proportion—1.4% of the total banking system assets, 2.7% of nominal GDP, and 3.6% of nominal non-oil GDP. This indicates a limited role in the overall financial system and economic development of the country. This prompts questions about whether these finance companies have lost their relevance in the contemporary financial ecosystem. A potential connection to this shift is explored in the context of corporate governance standards and structures, raising concerns about non-compliance (Ramani, 2020).

According to the most recent World Bank (2020) the United Arab Emirates (UAE) continues to be recognized as the premier business destination in the MENA region. This acknowledgment is attributed to the implementation of four new reforms within the preceding 12 months of 2019. The UAE was in the lead according to the World Bank (2020) rankings, than Bahrain, Saudi Arabia, Oman, Jordan, Qatar, and Kuwait. Notably, the UAE outperformed countries like Japan, Ireland, Switzerland, Canada, Germany, Finland, and several other well-developed nations, establishing itself as a highly favorable environment for conducting business (Dxbffplan, 2021).

Delving deeper into corporate governance reveals its pivotal role in shaping the dynamics of finance companies. Particularly, the focus is on boards of directors and ownership structures, where both internal and external governance mechanisms come into play. External tools, including takeover markets and legal mandates, serve as significant factors influencing corporate governance practices and decision-making processes. This intricate relationship underscores the need for a comprehensive examination of corporate governance in the UAE's financial landscape, especially in relation to the evolving role of finance companies.

2.2. Literature Theories

The concept of "corporate governance" is said to have emerged in the mid-20th century during the worldwide economic crisis of 1929 (Roe, 2005). It primarily focuses on the organisational frameworks of corporations and addresses issues pertaining to ownership and control within major publicly listed companies. Other factors, such as instances of corporate wrongdoing, economic recessions, and the growing significance of publicly traded corporations in the global financial arena, have also influenced the evolution of corporate governance. The "Cadbury Report," published in 1992 in the United Kingdom, provided a set of corporate governance principles that were designed to establish legal norms and protocols with the objective of fostering firm accountability, transparency, and responsible governance (Boyd, 1996; Shah & Napier, 1992). Hence, this research offers a thorough and meticulously analyzed set of recommendations and criteria for assessing the implementation of Corporate Governance (CG) in the banking sector across various MENA countries, including banking institutions operating in the UAE regions. In the context of the UAE's financial sector, characterized by a favorable low-interest rate environment, it serves as an appealing backdrop for investors in need of additional credit for their business ventures (Atradius, 2021).

2.3. Institutional Theory

The emergence of institutional theory can be attributed to significant social, organizational, and economic foundations. The original advancement of this hypothesis was proposed by renowned researchers Meyer and Rowan (1977) as well as DiMaggio and Powell (1983). According to the institutional theory, institutions have a significant impact on organization by influencing their behavioural tendencies and decision-making processes. The maintenance of regulatory duties within the framework of institutional theory necessitates the utmost significance of corporate governance. The banking sector operates within the parameters of governmental regulations, legal frameworks, cultural norms, and public expectations.

The Dodd-Frank legislation serves as a prime example of the imperative nature of efficient governance and openness in governmental regulations (Gray & Ehoff Jr, 2015). The enactment of the Wall Street Reform and Consumer Protection Act was a direct response to the financial crisis of 2008, and its primary objective was to strengthen regulatory frameworks governing financial firms within the United States (Murdock, 2011). The adoption of increased capital requirements and the creation of the Consumer Financial Protection Bureau have had a noticeable influence on the risk management and operational strategies utilized by banks.

According to scholarly literature, it is widely acknowledged that government rules have a significant impact on fostering market stability, hence providing benefits for enterprises (Jesover & Kirkpatrick, 2005; Kirkpatrick, 2009). According to the UN Environment (2017), the existence of a stable business environment facilitates a sense of predictability, enabling companies to formulate long-term goals, make prudent investment choices, and attract investors by mitigating perceived risks. Regulations also have a crucial role in bolstering trust and confidence in the marketplace through their recognition of stakeholder interests (Gonzalez & Garcia-Meca, 2014). In addition, consumers' inclination to participate in transactions and establish enduring ties with organizations is heightened when they have the view that their rights and interests are adequately protected (Coglianese, 2007). Through the implementation of this policy, organizations are afforded the ability to embrace specific practices, augmenting their legitimacy and competitiveness (Deephouse, 1996; Patten, 1991). Firms in various industries implement corporate governance rules and standards in response to prevalent institutional norms.

The institutional concept also states that legitimacy isomorphizes (DiMaggio & Powell, 1983). Freitas and Guimarães (2007) suggested isomorphism for standardisation or homogenization. These sorts of isomorphism have affected social analysts since the organisation environment changed (Amenta & Ramsey, 2010). According to institutional theory, a combination of formal and informal institutions, such as statutory requirements, industry standards, and public expectations, influence the level of board independence within a corporation (Freitas & Guimarães, 2007). For example, regulations pertaining to securities and corporate governance frequently mandate that firms maintain a specific proportion of independent members within their board structures. Further, this theory also suggests that organizations may mimic the practices of successful peers or competitors (Deephouse, 1996). If firms in a particular industry or region adopt greater board independence, others are likely to follow suit to maintain legitimacy and reputation (Alciatore & Dee, 2006).

Board compensation is another area that fits with institutional theory in this paper. Institutional theory explains that these structures are influenced not only by economic factors but also by a company's institutional environment. Board compensation is frequently determined by customary practices in a particular industry or region (Baker, Jensen, & Murphy, 1988). For instance, industries with intense director talent competition may offer more generous compensation arrangements. Additionally, activist shareholders can exert pressure on

corporations to align director compensation with shareholder interests (Mangel & Singh, 1993). It is anticipated that this outcome will lead to changes to board compensation practices. As stated by Carpenter and Feroz (2001), an institution operates within the constraints of social norms and places a high value on adhering to generally accepted standards. Hence, the organizations with effective governance systems are more likely to gain the trust of stakeholders and the general public, thereby enhancing their long-term viability and reputation (Drucker, 2004).

Consistent with the inclusion of another variable in this research, namely board ownership, it is plausible that organizations characterized by substantial institutional ownership may have directors who concurrently serve as institutional representatives. While certain organizations may promote the idea of directors possessing significant ownership shares in order to align their interests with shareholders, there are others that may not prioritize this particular feature (Ogden & Watson, 1999; Pöyry & Maury, 2010). In order to establish a connection with corporate governance regulations, it is possible for them to require a minimum number of directorship (Connelly, Hoskisson, Tihanyi, & Certo, 2010; Thomsen, 2004). This phenomenon might be interpreted as a deliberate endeavor by institutions to synchronize the interests of directors with the long-term value of shareholders. The concept of institutional theory places significant emphasis on the principles of independence, transparency, and disclosure. It is imperative for organisations to provide comprehensive elucidation of their governance structures and practises to company board and other stakeholders.

2.4. Stakeholder Theory

The notion of stakeholder theory is based on Freeman et al. (1984) paradigm shift in how organization should be managed and governed. Freeman mentioned that an organization is not solely accountable to shareholders but to a broader set of stakeholders who have a vested interest in the organization's activities. The term 'stakeholders' is not only ethically sound but also leads to better organizational performance and long-term success. To expand the understanding of stakeholder theory, several academic publications and international financial institutions, including Basel and the Organisation for Economic Co-operation and Development (OECD), have conducted thorough research on the influence of corporate governance structures and processes on the performance of the banking sector from the overall perspective of stakeholders (Ahmed, 2017; Farah, Elias, Aguilera, & Abi Saad, 2021). The concentration of ownership among primary stakeholders enables the strengthening of the Chief Executive Officer's (CEO) power and improves the financial performance of the banking sector during periods of economic turmoil (Hill & Jones, 1992). Managers possess a significant level of clout and influence, enabling them to exercise control over several aspects such as policy, strategy, and the interests of their stakeholders (Heath & Norman, 2004).

According to the research conducted by Barry, Lepetit, and Tarazi (2011), the performance of a bank during a crisis is significantly impacted by the concentration and nature of its ownership. Researchers have conducted studies to analyse the influence of corporate governance on the performance of banks, specifically in relation to factors such as capital structure and bank size. According to the research conducted by Aslam, Ahmad, Amin, Usman, and Arif (2018), it has been determined that the meticulous organisation of a bank's capital base can have a favourable impact on its risk profile and overall performance. Similarly, larger financial institutions may face distinct governance difficulties that require strong structures to assure the effectiveness of their operations.

These scholars had anticipated the rise and centralization of authority among professional managers, commonly referred to as "the shareholders," who aim to generate profits from the resources owned by others. The property rights theory stated that the elimination of the distinction between ownership and control would effectively resolve conflicts between owners and managers. According to the stakeholder theory, the concept of corporate governance posits that a company's board of directors should take into account the concerns and welfare of a wider array of stakeholders, extending beyond the sole focus on shareholders. For example, an expanded board may facilitate a broader range of perspectives and knowledge, thereby potentially enhancing the representation of varied stakeholders' interests.

Nevertheless, it is imperative to maintain a harmonious equilibrium, as too-sizable boards have the potential to become cumbersome and less efficient. Stakeholder theory frequently promotes a significant level of board independence from management with regards to this aspect of board independence. The anticipated role of independent directors encompasses the obligation to prioritise the welfare of all stakeholders, extending beyond the interests of management or shareholders only. Stakeholders can offer checks and balances, facilitating the inclusion of various perspectives and interests in decision-making processes.

Moreover, it is worth noting that corporate governance studies have also highlighted the significance of board diversity, particularly with regards to gender, ethnicity, and competence. According to Rodriguez-Fernandez (2016), empirical studies have provided evidence supporting the notion that boards with greater diversity exhibit enhanced performance and risk management capabilities. This can be attributed to the broader range of perspectives and competencies brought forth by a diverse composition. The frequency and effectiveness of board meetings have been found to have a positive correlation with improved corporate governance procedures and performance outcomes (corporate governance and banking performance).

3. Methodology and Research Design

3.1. Data Selections

From 2016 to 2020, a comprehensive sample consisting of 141 financial institutions from 12 countries in the Middle East and North Africa (MENA) area, including the United Arab Emirates, Qatar, Saudi Arabia, Oman, Jordan, Israel, Iran, Morocco, Kuwait, Egypt, Turkey, and Lebanon, was collected for the purpose of the study. This sample facilitates a comparative analysis of commercial banks operating in the wider Middle East and North Africa (MENA) area, with a specific focus on banks in the United Arab Emirates (UAE). In order to ensure the comprehensiveness of the data, this study eliminated financial organizations that did not possess thorough information regarding both financial and non-financial corporate governance.

The research methodology involves the manual extraction of annual reports as a means of evaluating the corporate governance practices of the banks. It is worth mentioning that the variables associated with corporate governance demonstrate a considerable degree of reliability due to the regular and consistent reporting to investors on an annual basis. The yearly reports were made accessible to the public through various web firms, including Orbis, which provides extensive information on organizational structure and financial resources.

In addition, credible organizations such as the World Bank and the International Monetary Fund (IMF) have furnished crucial data pertaining to the Gross Domestic Product (GDP) of individual nations. This study examines multiple dimensions of board structure, ownership concentration, meetings, and executive and non-executive remuneration. Furthermore, the examination of variables such as capital structure, bank size, and GDP allows for the assessment of the influence of independent variables on the dependent variable.

3.2. Independent Variables

3.2.1. Corporate Governance Mechanisms

This research uses principle components analysis (PCA) and corporate governance (CG) to compare board size, independence, diversification, meetings, remuneration, and ownership concentration. The comparison tool allows us to see how corporate governance affects Tobin's Q (TBQ), ROE, and ROTA. PCA may compress vast amounts of data into a single statistic that adequately reflects the whole. It employs linear combinations of original variables to explain as much variation as possible and prioritize data. Moreover, it helps increase indicator "efficiency" (Callens & Tyteca, 1999) by setting weights based on data rather than researcher preference.

3.2.2. Board Structure (Board Size and Independence)

The board of directors plays a crucial role in both the agency theory concept of company management (the stakeholder theory) and the institutional theory concept of supplying all necessary resources to the organization. According to Pillai and Al-Malkawi (2018), increasing the size of the board may improve management's ability to make decisions and share information, as well as decrease the likelihood that these decisions will be incorrect. The ratio of outside directors to total board members is an important metric to consider.

3.2.3. Ownership Concentration

By pooling their resources, powerful owners can exert undue influence on management and ensure that their interests are prioritized. The ownership structure of a corporation determines its corporate governance, which in turn affects the efficiency of the business. Does a single shareholder hold the majority of the company's voting stock, veto power, or golden shares? Numerous studies have demonstrated a positive correlation between ownership structure and company performance, which can inspire investor and stakeholder confidence. According to the stakeholder theory, the management must consider the interests of all relevant parties.

3.2.4. Board Meetings

The frequency, organization, and efficacy of board meetings are essential factors to be taken into account. Regularly scheduled and properly structured meetings facilitate active participation, in-depth deliberations, and comprehensive analysis of pertinent matters. Furthermore, they play a crucial role in facilitating efficient supervision, allowing directors to remain well-informed about the performance of the business and effectively tackle any emerging difficulties or opportunities.

3.2.5. Board Diversity

The concept of diversity can embrace various characteristics, including but not limited to gender, ethnicity, industry expertise, functional background, and foreign exposure. The inclusion of a diverse board can contribute to a more comprehensive array of perspectives during the decision-making process, thereby promoting creativity and innovation. Additionally, this practice aids in guaranteeing that the board accurately represents the interests and values of a wide range of stakeholders, thereby resulting in more comprehensive and efficient governance.

3.2.6. Compensation

This practice guarantees that leaders are motivated to make decisions that promote the long-term prosperity and viability of the firm, rather than giving priority to immediate advantages. Metrics such as the ratio between CEO compensation and median staff compensation, as well as the prevalence of performance-based incentives, can provide useful insights into the alignment of interests inside an organization. In this study, we have combined all of these different variables into an integrated domain known as CG, which will be applied for the purpose of our research in the subsequent chapter.

3.3. Dependent Variables

3.3.1. Financial Performance

EPS, ROA, NPM, and the debt-to-equity ratio are used to quantify company performance (Christensen, Kent, & Stewart, 2010). Using accounting-based financial performance evaluation tools, we can evaluate management team stewardship through historical and present financial data. Christensen also believed that financial performance evaluations may be biased and manipulated to meet management's objectives and may not accurately reflect the organization's status. Therefore, Core, Guay, and Rusticus (2006), proposed the return on assets (ROA) applied to operating profit as a more trustworthy financial performance criterion to measure financial performance and corporate governance. According to Core et al. (2006) leverage and other unusual circumstances have no effect on ROA. Meanwhile, Muth and Donaldson (1998) and Brown and Caylor (2009) endorsed ROA as a financial performance indicator for corporate governance.

3.4. Control Variables

3.4.1. Capital Structure/Leverage

The integration of debt and equity represents a viable approach for a firm to secure the financial resources necessary to support its operational activities and facilitate future expansion. The predominant sources of funding for a corporation commonly comprise short-term and long-term debt, as well as stock and other variants of equity. Various theories, such as the Stakeholder Theory and the Institutional Theory emphasize the significance of capital structure in influencing the success of a corporation.

3.4.2. Bank Size

The value of financial institutions' assets serves as a measure of its overall size, or bank size. Firm performance evaluations should take the size of the organization into account, since larger firms may have more management-shareholder problems, necessitating stringent governance frameworks (Hamdani & Hannes, 2019; Lohde, Campopiano, & Calabro, 2021).

3.4.3. Gross Domestic Product

GDP is the market value of all final products and services generated within a country's economy over a certain period of time.

3.5. Data Analysis Procedure

Researchers used quantitative data collection for their study. The breadth of the research necessitates quantifiable data and uses secondary data. Articles, research papers, websites, journals, annual reports, and the Orbis Database provide the data. Research on the DPD model examines the performance of MENA banks over a five-year period. The estimation of pooled regression, fixed effect, and random effect panel models is complex. Each method employs various heterogeneous properties of the cross-sectional or temporal model. DPD captures heterogeneity.

Holtz-Eakin popularized DPD, which Arellano and Bond (1991) created, but the estimation of the DPD panel data does not use model heterogeneity. DPD employing generalized method of moments (GMM) helps these applications as well. The instrumental variable-based GMM-DPD may capture time-invariant features of nations. Arellano and Bond's method works effectively in panel models with large cross-sectional units and short periods (Roodman, 2009). The GMM system has supplementary tools. Small panels function well with GMMs. GMM is an ML estimator, but it sacrifices efficiency for more robust assumptions about random variable moments than ML.

The current study also uses the multivariate statistical weighting approach, Principle Components Analysis (PCA), to generate a single comparison tool, corporate governance (CG), by combining variables such as board size, board independence, board diversification, board meeting, remuneration and ownership concentration. Using the comparison tool as an independent variable, it is easy to find the impact of corporate governance as independent variables on the dependent variable Tobin's Q (TBQ) Return on equity (ROE) and Return on total assets (ROTA).

Principle Components Analysis (PCA) is the process of converting many factors into a single factor, which represents the whole data. PCA weights data by combining original variables into linear combinations that explain as much variation as possible. In this way, PCA provides a relatively 'objective' approach for setting

weights that is dictated by the data rather than the analyst [García-Granero, Piedra-Muñoz, and Galdeano-Gómez \(2018\)](#) and it is a useful tool for improving the 'efficiency' of indicators ([Callens & Tyteca, 1999](#)).

4. Results and Discussion

4.1. Dynamic Model for UAE Banks

There are problems in estimating the panel model with the help of Pooled Regression, Fixed Effect (FE), and Random Effect (RE). These methods exploit different heterogeneous cross-sectional or time-specific information in the model. To capture such heterogeneity Dynamic Panel Data (DPD) approach is considered more efficient in this regard. DPD approach was developed by [Arellano and Bond \(1991\)](#) to estimate the panel data and does not exploit any heterogeneous information in model. Further, Generalized Method of Moments (GMM) instrument-based DPD is also equally efficient for such proposals. The instrumental-based GMM-DPD is capable of capturing the time-invariant characteristics of countries. Simultaneously, in the case where an individual possesses extended cross-sectional units with a restricted time period within a panel model, the Arellano and Bond technique demonstrates favorable behavior under such conditions ([Roodman, 2009](#)). The System GMM is utilized in our investigation, which incorporates a more extensive array of instruments compared to the Difference GMM. This method enhances the efficiency of estimating parameters for panel datasets with a limited number of observations. Moreover, this approach relies on making assumptions about individual occurrences of random variables, rather than assumptions about the entire distribution. GMM is considered more efficient in case of short panel. The generalized method of moments (GMM) is a method for constructing estimators, analogous to maximum likelihood (ML). GMM uses assumptions about specific moments of the random variables instead of assumptions about the entire distribution, which makes GMM more robust than ML, at the cost of some efficiency ([Zsohar, 2012](#)).

The following [Table 1](#) contains the dynamic one-step system GMM for three models of UAE banks, as system GMM increased the efficiency of estimated parameters.

The aforementioned [Table 1](#) presents the findings about the influence of corporate governance on three performance indicators of UAE banks. The initial component of dynamic analysis pertains to the influence of the lagged values of TBQ CG, GDP, Lev, and Size on TBQ. The speed of adjustment can be determined to be around forty-seven percent ($1-0.525$). The presence of a positive and statistically significant lagged value indicates that there is a dynamically stable relationship among the variables in the model. The observed rate of adjustment indicates that in the event of suboptimal financial performance in the short term, UAE banks are likely to converge towards a more stable long-term performance trajectory. The initial independent variable, namely CG, exhibits a positive and statistically significant influence on the TBQ of banks in the United Arab Emirates. There are six distinct variables that are transformed into a composite variable with the name of CG. If these six variables are improved on average, then they have a positive impact on TBQ in form of CG. The stakeholder theory is reinforced by the notion that the obligation to safeguard the interests of shareholders lies with corporate representatives, specifically the top management. The role entails taking into account the demands and concerns of the several stakeholders associated with the firm, with a specific focus on the banking business in the United Arab Emirates. Given the status of the UAE as an international metropolis and its significant involvement in global financial operations, it is imperative for the banking industry in the UAE to exercise prudence and sound judgment in such circumstances. Similarly, it can be observed that the market capitalizations of UAE banks are positively and significantly influenced by factors such as GDP growth rate and bank size. The last independent variable is leverage (Lev) in this model. The impact of Lev is adverse on TBQ of UAE banks. As total debt-to-total assets ratio of UAE banks increases, it affects their performance in form of low TBQ. At the end, the p-value of Sargan test is 0.38, which confirms that all utilized instruments are valid and exogenous ([Roodman, 2009](#)). Arellano Bond test for (AR (1)) testified that there is no issue of average autocovariance in residual order one.

This paragraph discusses the influence of corporate governance on three performance indicators of banks in the UAE, as presented in [Table 1](#). The initial component of dynamic analysis pertains to the influence of lagged values of ROE, CG, GDP, lev and firm size on ROE. The speed of adjustment is approximately sixty percent. ($1-1.609$). The positive and statistically significant value of lagged value ensures dynamically stable relationship among the variables of model. This speed of adjustment shows that if the financial performance of UAE banks is suboptimal in the short run, then it has high tendency to move to a stable long-term path of performance.

Table 1. Dynamic model for UAE banks.

Dynamic (One-step system GMM) TBQ dependent variable					Dynamic (One-step system GMM) ROE dependent variable				Dynamic (One-step system GMM) ROTA dependent variable			
	Coef.	Std. er	Z value	P value	Coef.	Std.er	Z value	P value	Coef.	Std. er	Z value	P value
Lagged TBQ	0.525	0.123	4.260	0.002								
Lagged ROE					1.609	0.536	3.000	0.003				
Lagged ROTA									1.075	0.395	2.720	0.006
CG	0.004	0.003	1.510	0.004	0.005	0.007	0.730	0.468	0.001	0.001	0.870	0.385
GDP	0.002	0.001	2.500	0.002	0.006	0.003	2.240	0.025	0.001	0.000	2.140	0.032
Size	0.024	0.008	3.080	0.024	-0.009	0.030	-0.310	0.753	0.001	0.004	0.250	0.806
Lev	-0.460	0.233	-1.980	-0.0460	-0.852	0.711	-1.200	0.231	-0.050	0.123	-0.410	0.683
Cons	0.181	0.216	0.840	0.403	0.748	0.593	1.260	0.207	0.027	0.103	0.260	0.791
No of obs.	17				26				26			
No of groups	07				08				08			
Sargan test of overidentification				0.38	0.018				0.14			
Wald chi				0.00	0.00				0.00			
Arellano-Bond test for AR(1)				0.036	0.12				0.101			
Arellano-Bond test for AR(2)				0.69	0.62				0.22			

The first independent variable, corporate governance (CG), shows an insignificant impact on ROE of UAE banks. It is quite natural that returns on capital investments are slowly transmitted into profits. In the present case of UAE, study implies only a short time span that doesn't capture the outcomes of capital market returns accurately. Another reason for the insignificance of corporate governance is adverse shock of pandemic COVID-2019. Pandemic COVID-19 relatively disturbs organized capital markets more as compared to unorganized capital markets.

UAE markets are relatively sophisticated, as this country is considered the financial hub of MENA region. Likewise, only the variable GDP has positive and significant impact on market capitalizations of UAE banks, whereas bank size (Size) and leverage (Lev) in this model have an adverse effect on ROE of UAE banks. The UAE Central Bank took steps to boost liquidity in the UAE market, such as offering collateralized loans with a zero percent (0%) interest rate, lowering reserve ratios on demand deposits, and modifying liquidity requirements. These measures were implemented with the aim of alleviating the economic repercussions of the COVID-19 pandemic (Atradius, 2021). As total debt-to-total assets ratio of UAE banks increases, it affects their performance in form of low ROE. At last, the p-value of Sargan test is 0.018, which confirms that all utilized instruments are valid and exogamous (Roodman, 2009). Arellano Bond test for (AR (1) testified that there is no issue of average autocovariance in residual order one. The impact of corporate governance on three performance-indicators of banks in the UAE is reported in Table 1. The first part of dynamic analysis is related to role of lagged values of ROTA CG, GDP, Lev, and Size on ROTA. It can be observed that the speed of adjustment is approximately seven percent (1-1.075). The positive and statistically significant value of lagged value ensures the dynamically stable relationship among the variables of model. This speed of adjustment shows that if the financial performance of UAE banks is suboptimal in the short run, then it has high tendency to move long run stable path of performance. Most of the variables such corporate governance (CG), bank size (Size) and leverage (Lev) have statistically in-significant impact on ROTA of UAE banks whereas the variable GDP growth rate has positive and significant impact on market capitalizations of UAE banks. At the last the p-value of Sargan test is 0.14 which confirms that all utilized instruments are valid and exogamous (Roodman, 2009). Arellano Bond test for (AR (1) testified that there is no issue of average auto covariance in residual order one.

4.2. Dynamic Model for MENA Region

This section contains dynamic behavior of corporate behavior and bank performance in form of TBQ, ROE, and ROTA for MENA region banks. Moreover, the other controlled variables are same as in the UAE.

The following table contains the dynamic one-step system GMM for three models of MENA banks, as system GMM increased the efficiency of estimated parameters.

Table 2 is about the Dynamic Model for MENA region banks. In this table the impact of corporate governance on three performance-indicators (TBQ, ROE and ROTA) of banks of MENA is reported. To capture the dynamic behavior we have used the lag value and the first part of dynamic analysis is related to role of the lag value of Tobin's Q ratio (TBQ), corporate governance, GDP growth rate, Leverage, and bank Size on TBQ. It can be observed that the speed of adjustment is about 1.8 percent (1-0.982). The positive and statistically significant value of lag ensures the dynamically stable relationship among the variables of model. This speed of adjustment shows that if the financial performance of MENA banks is suboptimal in the short run, then it has high tendency to move long run stable path of performance. In the above table the impact of the variables corporate governance (CG) and leverage (Lev) is statistically insignificant on TBQ of MENA banks whereas GDP growth rate and bank size (Size) have positive and significant impact on market capitalizations of UAE banks. At the end, the p-value of Sargan test is 0.00, which confirms that all utilized instruments are valid and exogamous (Roodman, 2009). Arellano Bond test for (AR (1) testified that there is no issue of average autocovariance in residual order one.

Similarly, the second part of dynamic analysis is related to role of the lagged value of ROE CG, GDP, Lev, and Size on ROE. The speed of adjustment is about twenty-two percent (1-1.222). The positive and statistically significant value of lagged value ensures a dynamically stable relationship among the variables of model. This speed of adjustment shows that if the financial performance of MENA banks is suboptimal in the short run, then it has high tendency to move long run stable path of performance. The variable is corporate governance (CG) shows positive and significant impact on ROE of MENA banks. There are six distinct variables that are transformed into a composite variable with the name of CG. If these six variables are improved on average, then these bring positive impact on ROE in form of CG. From the standpoint of stakeholders, representatives within the banking sector in the MENA region have a vital responsibility to protect the interests of their directors. Due to the significant global recognition of the UAE as a central hub for international financial operations, it is imperative for the banking industry in the MENA area to demonstrate caution and prioritize the welfare of diverse stakeholders engaged in these activities. Likewise, the variable GDP and has a positive and significant impact on market capitalizations of MENA banks but the variables is bank size (Size) and leverage (Lev) in this model have adverse on ROE of MENA banks. As total debt to total assets ratio of UAE banks increases, it affects the performance in form of low ROE.

Table 2. Dynamic model for MENA region banks.

Dynamic (One-step system GMM) TBQ dependent variable					Dynamic (One-step system GMM) ROE dependent variable				Dynamic (One-step system GMM) ROTA dependent variable			
	Coef.	Std. er	Z value	P value	Coef.	Std. er	Z value	P value	Coef.	Std. er	Z value	P value
Lagged TBQ	0.982	0.125	7.870	0.000								
Lagged ROE					1.222	0.206	5.930	0.000				
Lagged ROTA									1.302	0.242	5.390	0.000
CG	0.004	0.002	1.580	0.114	0.041	0.009	4.540	0.000	0.006	0.002	3.310	0.001
GDP	0.003	0.001	2.980	0.003	0.003	0.001	2.230	0.026	0.001	0.000	2.430	0.015
Size	0.005	0.003	1.650	0.099	0.002	0.005	0.390	0.700	0.000	0.001	0.490	0.624
Lev	0.003	0.030	0.110	0.916	0.006	0.040	0.140	0.888	0.005	0.007	0.750	0.453
Cons.	-0.062	0.036	-1.760	0.079	-0.057	0.051	-1.120	0.263	-0.014	0.008	-1.660	0.098
No of obs.	217				217				217			
No of groups	62				62				62			
Sargan test of overidentification	0.00				0.00				0.00			
Wald chi	0.00				0.00				0.00			
Arellano-Bond test for AR(1)	0.018				0.00				0.00			
Arellano-Bond test for AR(2)	0.65				0.50				0.05			

At the end, the p-value of Sargan test is 0.000, which confirms that all utilized instruments are valid and exogenous (Roodman, 2009). Arellano Bond test for (AR (1) testified that there is no issue of average autocovariance in residual order one.

Likewise, in Table 2, the last part of dynamic analysis is related to role of lagged values of ROTA CG, GDP, Lev, and Size on ROTA. It can be observed that the speed of adjustment is about three percent (1-1.302). The positive and statistically significant value of lagged value is ensuring the dynamically stable relation among the variables of model. This speed of adjustment shows that if the financial performance of MENA banks is sub optimal in the short run, then it has high tendency to move long run stable path of performance. The variable s financial governance (CG) and variable GDP growth rate has positive and significant impact on ROTA of UAE banks whereas bank size (Size) and leverage (Lev) have statistically insignificant impact on market capitalizations of MENA region banks. At the end, the p-value of Sargan test is 0.14, which confirms that all utilized instruments are valid and exogenous (Roodman, 2009). Arellano Bond test for (AR (1) testified that there is no issue of average autocovariance in residual order one.

5. Conclusion

5.1. Implications

The study's findings have several implications for the understanding of corporate governance (CG) in the banking sector, particularly in the MENA region and the UAE. First and foremost, the observed dynamic stability in the relationship between CG and various performance indicators underscores the significance of effective governance mechanisms. The positive and significant impact of CG on Return on Equity (ROE) and Return on Total Assets (ROTA) in MENA banks suggests that a strong governance framework contributes to improved financial performance.

The identification of the UAE as having better CG mechanisms than other MENA region banks highlights the potential attractiveness of the UAE for investors. The recent regulatory changes allowing 100% foreign ownership and other investor-friendly policies have positioned the UAE as a favorable destination for Foreign Direct Investment (FDI). The study aligns with previous reports ranking the UAE high in terms of FDI attractiveness, making it a compelling choice for international investors.

Moreover, the study's analysis of the influence of GDP growth rate, bank size, and market capitalization on performance indicators provides insights into the broader economic factors affecting banks in the MENA region. The positive impact of these factors on market capitalization indicates the importance of economic growth and the size of the banking institution in determining market value.

5.2. Limitations

Despite the valuable insights gained from this study, there are certain limitations that should be acknowledged. Firstly, the study relies on historical data, and the dynamic nature of economic and regulatory environments may introduce changes that the historical data might not capture. Additionally, the focus on the banking sector may limit the generalizability of the findings to other industries within the MENA region.

Another limitation lies in the relatively short time frame covered by the study, limiting the ability to observe long-term trends and the sustained impact of governance mechanisms. The study also assumes a linear relationship between variables, neglecting potential non-linear dynamics that may exist. Furthermore, the study's reliance on quantitative data may overlook qualitative aspects of corporate governance, such as the quality of board decision-making and the ethical dimensions of governance practices.

5.3. Future Research Suggestions

To build upon this study, future research could explore the specific mechanisms within corporate governance that contribute most significantly to improved bank performance. Qualitative research methods, such as interviews and case studies, could provide deeper insights into the actual governance practices and their impact.

Comparative studies across different sectors and industries within the MENA region could broaden our understanding of how corporate governance dynamics vary across contexts. Exploring the influence of cultural and institutional factors on governance practices could also enhance the understanding of regional variations.

Moreover, given the evolving nature of regulatory frameworks, future research could investigate the impact of recent regulatory changes, such as foreign ownership policies, on investor perceptions and actual investment flows. Longitudinal studies could track the changes in governance practices and their impact over an extended period.

In conclusion, while this study contributes valuable insights into the relationship between corporate governance and bank performance in the MENA region, there is room for enhancement by addressing these limitations and delving into future research directions.

6. Recommendations

The lack of corporate governance data for MENA firms has limited studies on business leadership and financial performance. The data range also covered the COVID-19 era (2006–2020), during which financial institutions had difficulty collecting loan and mortgage payments as well as other receivables, forcing many to write off consumer and SME loans and mortgages in anticipation of never being able to collect them. Future research should evaluate the impact of COVID-19 on corporate governance before and after its implementation, and should include more MENA and UAE institutions. Future investigations may extend beyond commercial banking.

There is a wealth of research on banking, finance, and other industries. Surveys, case studies, and interviews are needed to study how corporate governance affects company performance and value. Academic possibilities exist. Moreover, initiatives by policymakers to promote corporate governance enforcement in MENA have the potential to increase agency expenses, financial performance, and enterprise value.

Corporate governance and commercial performance in MENA, where numerous conglomerates are owned and supervised by royal families or have significant stakes in publicly traded firms, would be intriguing to study. Since company ownership concentration hurts financial performance, MENA corporate governance has been studied. Stakeholders benefit from ethical and CG business practices. As the company expands, CG and ethics are harder to manage. Today, most individuals would prefer to invest rather than operate a business, making management discretion and corporate success more desirable. We investigate the effect of the CG mechanism on firm performance because, particularly after COVID-19, individuals have been investing massively in shares to earn a rapid profit, whether in Amazon, Coke, Tesla, or crypto currency.

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