Corporate Governance Practices of the Middle East Banking Sector: A Comparative Analysis between Islamic and Conventional Banks

Wael Moustafa Hassan Mohamed, PhD, MBA

Abstract

The main objective of this research paper is to highlight the importance of corporate governance practices and also is to examine the main differences between Islamic Banks and Conventional Banks concerning corporate governance practices. Additionally, to investigate the most influential factor that has impact on corporate governance practices in both types of banks Islamic and Conventional. A mix between Qualitative and quantitative methods has been used to achieve research purposes. The results revealed that there is a significant difference between Islamic banks and conventional banks with regard to corporate governance practices and there is a variety with regard to influence of corporate governance variables on corporate governance practices.

Keywords: Corporate Governance Practices, Islamic Banks, Conventional Banks

Introduction

Corporate Governance is one of the most critical issues that affect the transparency and fairness in banking sector. The banking sector is considered as a basic pillar of the global economic system due to its significant impact on the development and stable growth in addition to its intermediation role in mobilizing funds. Accordingly, the existence of good practices of corporate governance is very important to guarantee financial justice and to set an official framework to ensure stakeholders rights.

Corporate Governance has no standardized definition as there are several scholars and researchers define corporate governance from different perspectives but generally, they define it either as a system or as a framework that determine how an organization is managed and all its related issues such as polices, structure, culture and strategies taking into consideration their relationship with diversity of stakeholders.

Generally, corporate governance can be defined as a framework that protect stakeholders’ rights by illustrating an effective board of directors, efficient internal control and audit in addition to reliable financial reporting and disclosure. Wheelen and Hunger (2006), demonstrated that corporate governance describe the relationship among shareholders, board of directors and the senior management to specify the track, road map and performance of the company. Corporate governance is the set of processes, customs, policies, laws, and institutions affecting the way a corporation (or company) is directed, administered or controlled. Corporate governance also includes the relationships among the many stakeholders involved and the goals for which the corporation is governed. In contemporary business corporations, the main external stakeholder groups are shareholders, debt holders, trade creditors, suppliers, customers and communities affected by the corporations activities. Internal stakeholders are the board of directors, executives, and other employees.

1 Senior Lecturer of Finance and Investment, Faculty of Financial and Administrative Sciences, Pharos University in Alexandria (PUA), Egypt. dr.wael.moustafa@pua.edu.eg
Recently, the global economic system had witnessed the expansion of Islamic Banking sector which still in the development stage, however Islamic banks and their services have attracted several researcher to deeply understand the difference between Islamic banking and Conventional banking services, especially after the Global financial crisis 2007 -2008 and its consequences.

Corporate governance plays a significant role to design and promote principles of equality, accountability, and transparency. However, it is observed that there is not much discussion or literature on the issue of corporate governance from the Islamic perspective. It is strongly indicated that any Islamic corporation particularly Islamic financial institution needs to have a solid governance model and proper strategies that will promote the adoption of strong and effective corporate governance within the Islamic paradigm. (Hasan , 2009).

1.1 Importance of Corporate Governance

The call for a comprehensive system of corporate governance came up as a result of inconsistency of interests across different stakeholders with different sights and objectives. The scandal and bankruptcy of international and large corporations such as Lemon Brother bank, Enron and WorldCom, has raised the concern of efficiency of good corporate governance practices and its impact on protecting stakeholder rights in a fairness financial system. The importance and effectiveness of corporate governance could be reviewed at different levels; corporate, shareholders and economy levels.

Corporate governance is important to set up the foundations for the relationship between the directors, board of directors and shareholders which leads to clarify the rights and obligations of each party to efficiently utilize the available resources and opportunities. Also, Effective corporate governance will lead to openness and access to global capital markets and attract a broad base of investors to finance expansion of projects. That’s to say, the application of the rules of corporate governance increases investor confidence because those rules ensure the protection of their rights.

From shareholders perspective, efficient corporate governance will help to ensure the rights of all stakeholders, such as the right to vote, the right to participate in decisions on any substantive changes that may affect the performance of established in the future. Also, It provides appropriate incentives for the board of directors and the managers to efficiently look for objectives that are in favor of the company and management interests. Finally, Good practices of corporate governance will ensure full disclosure of the financial position and economic performance On the national economy side, the Share prices of well governed companies are sold higher than companies that are not well governed. As institutional investors are willing to premium to buy share of well governed companies rather than investing in non-governed corporations. As long as there are well governed companies in the economy, this definitely will be reflected on the whole economy activity due to increase of confidence across different types of investors especially the institutional investors. Additionally, the possibility of integration between national economy and international economy.

2. Different Model of Corporate Governance

There are different model of corporate governance applied across the world, each model has its own characteristics and features. The next section will briefly review three different models namely: Anglo-Saxon Model, European Model, and Islamic Model of corporate governance

2.1 Anglo Saxon Model:

This model is well known as market based model and used by united state of America in addition to United Kingdom of Britain. This model concerns about the maximization of shareholder value and just look after the shareholder interests through increasing profitability and efficiency (Hasan, 2009 ). The international Chamber of commerce indicated that the ownership under the Anglo Saxon model is concentrated with few people that have authorities over the management team, this is done through an executive chairman and there is a poor shelter for minority investors who need independent director support. The Anglo-Saxon model of governance is characterized by widespread shareholding of equity and a stress on financial objectives by the companies. The objective of the governance system is to set up rules and guidelines so that board members and executives work to maximize shareholder wealth. Shareholders are viewed as the “risk takers” of the company.( Chan and Cheung 2004).
Miller (2004) argues that corporate governance under Anglo-Saxon Model concerns with shareholders value. In other word, the individual is sovereign and not the government, not the producers and not the merchants. Hassan (2009) argued that, Anglo Saxon Model relied on the fiduciary correlation between Managers and stockholders. Managers who are incentivized by bonus and profit share will increase profit as much as possible under the market capitalism concept. Participants in this market believe that the market is self regulated and will be balanced without force intervention. The most unique character of Anglo Saxon model is that the ownership of corporation is broadly dispersed and accordingly, the power and influence of shareholders on management are fragile. That’s why corporation under this model need a strong framework to ensure the protection of shareholders. In other words, The core of corporate governance in the Anglo-Saxon model is protecting stockholders’ rights.

**Figure 1.1 Angola Saxon Model of Corporate Governance**

![Diagram of Anglo Saxon Model](image1)

**Source:** Cernat, (2004: 1)

### 2.2. European Model

The European model is based on three propositions which obviously are opposite to Anglo-Saxon model. (Iqbal and Mirakhor, 2004: 46). These three propositions are concerned with stakeholder interests, rights and the managers responsibilities which can be summarized as follows:

1. Maximizing stakeholders’ interests and not only stockholders like Anglo-Saxon Model.
2. All stakeholders have the right to participate in the corporate decisions.
3. The manager main responsibilities are to protect stakeholders’ interests.

**Figure 1.2 European Model of Corporate Governance**

![Diagram of European Model](image2)

**Source:** Cernat, (2004: 153).

### 2.3. Islamic Model:

Islamic model of corporate governance relies on the stakeholder model; a stakeholder is defined as a person or groups that have a direct or indirect stake in an organization. This stake can be classified as a property rights which might be at risk because of organizations actions. Accordingly organizations are expected to protect such property rights for all stakeholders not only shareholders.
Iqbal and Mirakhor (2003; 2004) argued that, any groups or individuals who has explicit or implicit contractual obligations with an organization might be classified as stakeholders even if they don’t hold official contracts. Iqbal and Molyneux (2005), Stated that the Islamic contractual framework focus on the obligations that may arise from explicit and implicit contracts. Accordingly, organizations should honor the implicit contract or what so called “unwritten codes of conducts” to various stakeholders that may be affected by organizations’ actions. These implicit contracts are governed by Sharia’a.

Ahmed (2003), stated that the relationship between a man and his master is a divine contract and should be governed by sharia principles accordingly any conflict of interests among the society members shouldn’t be appeared if the followed these rules. Iqbal and Mirakhor (2004), stated that the corporate governance form Islamic perspective can be described as a system that has a critical goal which is to preserve stakeholders rights who might be exposed to any types of risk due organization’s actions. As Islamic contractual frame work, rely on two principles; property rights and contractual agreement. Consequently, protecting all rights and responsibilities across different interests groups is an essential aim for Islamic corporate governance. That’s is to say, The Islamic corporate governance model is based on balancing and synchronizing interests across different groups of stakeholders according to Shairaa principles of Holly Qur’ana and Sunnah of Prophet MOHAMED (PBUH).

**Figure 1.3 The Main dimension of Islamic Corporate Governance**

![Diagram](image.png)

**Author own figures based on Schieffer et al. (2008).**

Figure 1.3 explains the five dimensions of corporate governance from Islamic perspective theses dimensions are as follows:

- **Adl: (Justice)** represents equilibrium and fairness in every action in the life like passing judgments, responsibilities toward others, protecting society members’ rights regardless of their religion, sex, and nationalities. It’s a comprehensive framework for the overall society including individuals and institutions which considered as cornerstone for Islamic values.

- **Hisbah:** It’s an Islamic system in which the state has the right to inspect all practices in the market to ensure fairness and equity. These procedures may be extended to deeply inspect minor crimes in the society. In this system the state recruit inspector or supervisor or what so called Al-Mouhtasib.

- **Self-consciousness/mindfulness (alertness):** Schieffer et al. (2008), stated that “Islam puts strong emphasis on the conscious recognition of the interdependence between the invisible and the visible, whereby the invisible is regarded as the cause of the visible (“software leads hardware”). Hence, Good Governance starts on the psychological level of the individual.”
Al Tawheed: Connectiveness ("unity"), As per Islamic literature there are three levels of unity. Unity of humanity, Unity of the People of Book and Unity of Muslims. This concept should be applied on all parties within the organization.

- Shura: Consultancy – One of the main concepts in Islam is Shura (consultancy) this mean that the decision making process should be done through consultancy and not based on dictatorial actions.

**Figure 1.4** Islamic perspective of corporate governance function

![Diagram](source: Hassan 2008)

Figure 1.4 by Hassan (2008), revealed that the Shariaha board has a vital role in advising and oversight corporate transactions to guarantee that all procedures and process are complying to Islamic Shariaa rules. The board of directors has the a critical role, too. The critical role of the board of director is to oversight and supervise all business activities and make sure that all business functions are abide to the strategic direction of the corporation through monitoring senior managers' performance. The other stakeholders like employee and depositors have to perform their responsibilities accordingly. Also, regulator have a crucial role to supply the market with regulatory framework to ensure stability of the system.

From the above discussion of the three models, one can conclude that the corporate governance practice is a function of several variables such effectiveness of the board, supervisory board, shareholders’ rights, compensation, Audit and Disclosure & transparency.

3. Research Questions:
   1. What are the most influential factors that may affect the corporate governance practices of Islamic banks and Conventional banks in the Middle East?
   2. Is there a significant difference between Islamic banks and conventional banks in the Middle East with regard to corporate governance practices?

4. Hypotheses:
   This study examines eight null hypotheses to answer research questions, these hypotheses are as follows:
   
   Ho1. Effectiveness of the board, Supervisory board, shareholders’ rights, compensation, Audit and Disclosure & transparency have the same influential impact on corporate governance practices.

   Ho2: There is no significant difference between the Islamic Banks and conventional banks with regard to Corporate Governance Policies & Practices,
Ho3. There is no significant difference between the Islamic Banks and conventional banks with regard to Effectiveness of the Board.

Ho4. There is no significant difference between the Islamic Banks and conventional banks with regard to Supervisory Bodies.

Ho5. There is no significant difference between the Islamic Banks and conventional banks Shareholders’ Rights.

Ho6. There is no significant difference between the Islamic Banks and conventional banks with regard to Compensation.

Ho7. There is no significant difference between the Islamic Banks and conventional banks with regard to Audit.

Ho8. There is no significant difference between the Islamic Banks and conventional banks with regard to Disclosure and Transparency.

5. Methodology:

A questionnaire adopted for this study that contains 40 questions broken down into seven general categories namely: Corporate Governance Practices, Effectiveness of the Board, Supervisory Board, Shareholders’ Rights, Compensation, Audit and Disclosure and Transparency.

Accordingly, \( CGV = \text{function}(EFB, SBD, SHR, COM, AUD, DTP) \)

Where \( CGV \) is the dependent variable and \( EFB, SBD, SHR, COM \) and \( DTP \) are the independent variables.

5.1 Research Sample:

Twenty three Islamic banks and twenty six conventional banks were responded positively to the research questionnaire across six countries from the Middle East. Namely Egypt, Qatar, Bahrain, Saudi Arabia, Kuwait and UAE.

5.2. The Model

The regression model will be as follows:

\[ CGV = \beta_0 + \beta_1 EFB + \beta_2 SBD + \beta_3 SHR + \beta_4 COM + \beta_5 AUD + \beta_6 DTP + e \]

Where, 
\( CGV \) is the dependent variable, \( \beta_0 \) is the intercept, and \( E \) is the residual. The independent variables are \( \beta_1 \) to \( \beta_5 \). \( CGP= \text{Corporate Governance Policies & Practices}; SB = \text{Supervisory Bodies}; SHR= \text{Shareholders’ Right}; AUD= \text{Audit}; DPP= \text{Disclosure Policies and Practices}. \)

6. Results and Interpretation

The following section revealed results and interpretation of reliability, consistency, regression an ANOVA analysis.

6.1. Reliability and Consistency

Cronbach’s Alpha test used to examine reliability and consistency among the responses against each item in the questionnaire. The results for the seven subsections in the questionnaire as shown in table 6.6 revealed that the cronbach’s alpha is vary between 0.713 and 0.896 which indicate that there is an acceptable level of consistency among responses. In addition, the cronbach’s Alpha result for overall questionnaire is 0.936 which indicate that there is a very satisfied level of consistency among responses for overall questionnaire.
6.2. Multicollinearity

Multicollinearity can generate misleading results when attempting to examine how well individual independent variables could be used as predictors to understand the dependent variable. In general, multicollinearity could lead to a wide confidence intervals and strange P values for independent variables.

Pearson correlation is used to examine whether there is a multicollinearity problem among the explanatory variables or not. Anderson et al. (1990) states that any correlation coefficient exceeding (0.7) indicates a potential problem of multicollinearity. Results in table 6.2 revealed that, there is no problem of multicollinearity among these variables. The following table indicates the correlation coefficient between explanatory variable is varying. The maximum correlation coefficient is 0.597 and the lowest correlation coefficient is 0.025, which still in the acceptable range as indicated by Anderson et al. (1990).

<table>
<thead>
<tr>
<th></th>
<th>CGV</th>
<th>EFB</th>
<th>SBD</th>
<th>SHR</th>
<th>COM</th>
<th>AUD</th>
<th>DTP</th>
</tr>
</thead>
<tbody>
<tr>
<td>CGV</td>
<td>1.000</td>
<td></td>
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<tr>
<td>COM</td>
<td>0.168</td>
<td>0.092</td>
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<td>0.026</td>
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<td>AUD</td>
<td>0.445</td>
<td>0.597</td>
<td>0.152</td>
<td>0.554</td>
<td>0.160</td>
<td>1.000</td>
<td></td>
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<tr>
<td>DTP</td>
<td>0.128</td>
<td>0.033</td>
<td>0.041</td>
<td>0.029</td>
<td>0.097</td>
<td>0.025</td>
<td>1.000</td>
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</table>

Table 1.1

<table>
<thead>
<tr>
<th></th>
<th>CGV</th>
<th>EFB</th>
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<th>SHR</th>
<th>COM</th>
<th>AUD</th>
<th>DTP</th>
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<td>CGV</td>
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<tr>
<td>EFB</td>
<td>0.713</td>
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<tr>
<td>SBD</td>
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<tr>
<td>COM</td>
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<td></td>
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<tr>
<td>AUD</td>
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<tr>
<td>DTP</td>
<td>0.896</td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>Overall</td>
<td>0.936</td>
<td></td>
<td></td>
<td></td>
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</tr>
</tbody>
</table>

Table 1.2: Correlations Matrix
6.3 Regression Analysis:

This section revealed the results of regression analysis to test the hypothesis number 1 Ho:1. The following model was applied:

\[ \text{CGV}=\text{function}(\text{EFB}, \text{SBD}, \text{SHR}, \text{COM}, \text{AUD}, \text{DTP}) \]

Where CGV is the dependent variable and EFB, SBD, SHR, COM and DTP are the independent variables. The serious of the independent variables are extracted from the results of the questionnaire. As show in table 6.3.2 all independent variable have a positive and significant impact on corporate governance practice.

### Table 1.3

<table>
<thead>
<tr>
<th>Model Summary b</th>
</tr>
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<td>Model</td>
</tr>
<tr>
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<td>1</td>
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</table>

a. Predictors: (Constant), SBD, SHR, COM, AUD, DTP
b. Dependent Variable: CGV

The model summary as shown in table 6.3.1 revealed that the \( R^2 = 0.5741 \) which means that all independent variables can explain only 57.41% of the variation in corporate governance practices. Accordingly, there are another factors that may have a significant impact on corporate governance practices and its effectiveness.

### Table 1.3.1. Coefficient a.

<table>
<thead>
<tr>
<th>Model</th>
<th>Unstandardized Coefficients</th>
<th>Standardized Coefficients</th>
<th>t</th>
<th>Sig.</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Beta</td>
<td>Std. Error</td>
<td>Beta</td>
<td></td>
</tr>
<tr>
<td>1</td>
<td>(Constant)</td>
<td>-5.049</td>
<td>1.749</td>
<td>-2.887</td>
</tr>
<tr>
<td></td>
<td>EFB</td>
<td>0.640</td>
<td>0.529</td>
<td>0.633</td>
</tr>
<tr>
<td></td>
<td>SBD</td>
<td>0.276</td>
<td>0.204</td>
<td>0.265</td>
</tr>
<tr>
<td></td>
<td>SHR</td>
<td>0.264</td>
<td>0.131</td>
<td>0.240</td>
</tr>
<tr>
<td></td>
<td>COM</td>
<td>0.155</td>
<td>0.369</td>
<td>0.148</td>
</tr>
<tr>
<td></td>
<td>AUD</td>
<td>0.360</td>
<td>0.327</td>
<td>0.325</td>
</tr>
<tr>
<td></td>
<td>DTP</td>
<td>0.468</td>
<td>0.236</td>
<td>0.419</td>
</tr>
</tbody>
</table>

a. Dependent Variable: CGV

Based on the beta coefficient as revealed in table 1.3.1. The most significant independent factor that have influence in explaining the variability of corporate governance practices is effectiveness of the board (EFB), which show the importance of having board members with high qualification and efficient experience to manage and draw strategic plans for banks. This will let the board of directors to strategically manage banks in an efficient manner and understand the complicated factors that affect the bank performance. The result is consistent with Andres and Vallelado (2008), who found that bank board composition and size as elements of board effectiveness are related to directors’ ability to advise management and oversight management’s behavior and efficiently evaluating their decisions.

Accordingly enhance banks performance in form of return on equity (ROE) and return on asset (ROA). This result is also in accordance with Basel Committee on Banking Supervision (BCBS) recommendations, which called attention to the structure of the board of directors and senior management to increase the efficiency of monitoring and assure a sound financial system along with continuous development of economics. (BCBS, 2009). The result is also in line with the arguments of Grewl (2013), who argued that effectiveness of the boards are very critical factor for efficient corporate governance, as effective board members are working very hard to add value to the organization which will result in enhancing confidence in the governance process. Consequently, increasing organization’s value and guarantee sustainable development.
The second variable that influences the corporate governance practices is the disclosure and the transparency practices which assure the importance of the disclosure and transparency to build an effective framework of corporate governance thus providing an efficient basis for decision making by shareholders, investors and all stakeholders in terms of selecting appropriate investments and capital allocation in addition to oversight the financial performance of the financial institutions. This result is consistent with Fung (2014), who confirms that effective transparencies in disclosures procedures are very important for effective financial reporting and supervision. By applying high level of financial transparency, organizations can provide the required information for investors to review their governance process and behavior. The results also confirm the fact that, increasing transparency will be an essential element to sustain success and development of corporate governance. With high level of transparency and disclosure, banks will be able to protect stakeholders from frauds and from any prospect financial scandals that negatively affect the banks’ performance and its market share.

The third variable that has an influence on the dependent variable is audit (AUD) as the beta coefficient is 0.36. This result confirm the importance of having a professional and independent audit committee that able to protect the bank from any internal deviation versus the agreed and approved strategy by the board. Accordingly, protecting shareholders and stakeholders which lead to increasing the confidence in the bank, enhancing the profitability and financial stability. This argument is consistent with Anderson et al. (2004) who noted that audit committee oversight the internal control and provides credible information to the shareholders and to the stakeholders. Accordingly the audit committee enhance and strength the internal audit function in addition to its role in monitoring senior managements’ decision and assess it in a professional and effective manner to avoid and reduce potential risks (Hsu, 2007). This research result concerning audit committee is in line with Beasley et al.(2000), who argued that an effective audit committee with more meeting would have an appropriate time to oversight and monitor the process of the financial reporting, identifying risk and oversee the process of internal control as an effective element of comprehensive corporate governance framework.

The Fourth factor that significantly affects the corporate governance practices in banking sector is supervisory board or what so called supervisory body’s. It’s worth mentioned that in Islamic bank the supervisory board role is done through Shariaa board. According to Habib and Chapra (2002), the corporate governance under Islamic financial institution could be considered as a system that guarantee fairness for all stakeholders via transparent and accountable mechanism based on Islamic Sharia rules. The results in table 6.3.2 which revealed that the supervisory board has a significant explanatory power on the dependent variable (CGV) with beta coefficient 0.276 is supporting the above mentioned core idea about corporate governance in Islamic banking system. As a result, the board of shariaa is responsible for applying such system and facilitates the flow of fairness to all stakeholders under shariaa rules. The shariaa board is an independent body that direct, monitor, and supervise all transaction in Islamic banks as the main function of this board is to make sure that all transaction is in accordance with Islamic shariaa rules. The shariaa supervisory board has the power and the authority to reject any project or banking deal even if it has been already approved, recommended, or suggested by the board of directors (Matoussi and Grassa, 2012).

On the other hand, In conventional banking system the supervisory board is very critical, too and have an effective role to enhance the process of corporate governance in conventional banking system. The result also confirm the importance of the supervisory board to monitor the policies of the managing board and to maintain an effective and constructive relationship with shareholders, investors and stakeholders. In addition to assessing the banks’ strategies, risk tolerances and the development of the banks’ position in the market. Table 6.3.2 show that there is a significant and positive relationship between supervisory board and corporate governance practices. That’s to say, the stronger the supervisory board the stronger the corporate governance process and banks’ financial performance. The fifth variable that has a significant impact on corporate governance is shareholders’ rights. The beta coefficient is 0.264 and has a positive sign which mean that there is a positive relationship between shareholder rights and corporate governance practices. If the bank enhance the shareholders rights and protect their rights in voting and accessing required financial information this will help to enhance the corporate governance practices in the bank and increase the confidence of shareholder in banks’ management. The sixth and the last variable that has a significant influence in explaining the variation of corporate governance practices is the compensation committee. The beta coefficient as shown in table 6.3.2 is 0.155.
This result is confirming the importance and the critical function of the compensation committee to help senior management in identifying overall banks’ compensation policy, attract and maintain key persons specially at top management level and executive levels and link the compensation policy and programs to the objective the and performance of the banks. It’s worth mentioned that, the compensation committee has a critical role in approving and recommending equity based plan and modifying any existing one. Based on the above mentioned analysis the researcher rejects the first null hypothesis.

6.4 Examining the Difference between Islamic and Conventional Banks using ANOVA

The main purpose of ANOVA analysis is to investigate whether there is a significant difference between Islamic banks and conventional banks regarding corporate governance practice, Effectiveness of the board, supervisory board, Shareholders’ rights, compensation, audit, and Disclosure.

Table 1.4 ANOVA - Corporate Governance

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<th>Sum of Squares</th>
<th>df</th>
<th>Mean Square</th>
<th>F</th>
<th>Sig.</th>
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<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Between Groups</td>
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<td>4.635</td>
<td>25.108</td>
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</tr>
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<td>Within Groups</td>
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<td>249</td>
<td>0.197</td>
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<td></td>
</tr>
<tr>
<td>Total</td>
<td>53.688</td>
<td>250</td>
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<tr>
<td>EFB</td>
<td></td>
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</tr>
<tr>
<td>Between Groups</td>
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<td>1</td>
<td>5.845</td>
<td>9.481</td>
<td>0.317</td>
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<tr>
<td>Within Groups</td>
<td>14.193</td>
<td>249</td>
<td>0.057</td>
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<tr>
<td>Total</td>
<td>20.038</td>
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<td>SBD</td>
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**Significant at the 0.01 level (2-tailed), * Significant at the 0.05 level (2-tailed).

6.4.1 Corporate Governance Practices

The result of table 1.4 revealed that there is a significant difference in corporate governance between Islamic banks and conventional banks.
The main rational for this result is that the objective of corporate governance in Islamic banks is different from conventional banks. As Islamic banks consider corporate governance as a special, structure and framework that guarantee fairness (Adl – in Arabic) to all stakeholders and not to stockholders only like Anglo-Saxon model. Although there is, a similarity between Islamic model of corporate governance and the European model regarding fairness to stakeholders, however the structure of corporate governance in Islamic banks (model) is different due the existence of Shariaa board which is very critical to guarantee fairness based on Islamic rules. This argument is consistent with Habib and Chapra (2002). Additionally, this finding support the argument of Ibrahim (2006) who stated that the main pillars of corporate governance in Islamic financial institution are faith based approach to comply with Islamic shariaa rules and maximizing wealth of stakeholders.

6.4.2 Effectiveness of the Board.

Table 1.4 revealed that there is no significant difference between Islamic Banks and Conventional Banks with regard to effectiveness of the board. This results is in line with the Al Tammie (2012), who investigate the United Arab Emirates (UAE) national banks’ (Islamic and Conventional) practices of corporate governance regarding the role of the board of directors in the formulation and implementation of bank policies and strategies. This mean that the effectiveness of the board members including independence, expertise, board size are very important and critical for both types of bank to be able to implement banks’ policy and satisfy shareholders requirements in terms of profitability and appropriate risk management.

6.4.3 Supervisory Board.

Table 1.4 revealed that there is a significant difference between Islamic banks and conventional banks regarding supervisory board. The interpretation for this result rely on the fact of main role of Shariaa Supervisory Board (SBB) of Islamic banks that guarantee and insure all banking transactions including structuring and parties involved in it are in compliance with Islamic shariaa rules. Also, Shariaa board is very important because it reduce the inefficiency driven from asymmetric information and moral hazard (Suleimen, 2006).

6.4.4 Shareholder rights

Table 6.4 revealed that there is no significant difference between Islamic banks and conventional banks with regard to shareholder rights. This confirm the fact that, The shareholders have the right to vote, sell their shares, and participate in general assembly meetings and to participate in decision making with regard to critical decisions such as merger and acquisition in Islamic banks and conventional bank. (OCED, 2009).

6.4.5 Compensation

The result in table 1.4 shows that there is no significant difference between Islamic banks and conventional banks regarding compensation. Based on literature review and criticism to compensation system in banks it obvious that such criticism is applicable for both types of banks Islamic and conventional. One of the most critical criticism is that the compensation schemes do not take into consideration the relationship between the compensation of executives and risk taking strategies and its consequences. The only consideration is short term effect which might be measured by stock price development. One of the recommendations to enhance the compensation scheme for Islamic and conventional banks is that, the Board and Executives’ compensation should be deferred over long term period and the compensation committee should receive recommendation from risk management committee with regard to any adjustment for investment risk strategies that may affect the long term banks’ profitability and financial stability.

6.4.6 Audit

Table 1.4 revealed that there is a significant difference between Islamic banks and conventional banks with regard to Audit. This result is consistent with (Kasim et al, 2013), who argued that, The scope of auditing in Islamic banks is more complicated and extensive than the conventional banks. Besides attesting the accuracy of banking transaction from accounting point of view, it also includes expressing auditors’ opinion regarding honesty, efficiency, and effectiveness of management.
The main scope of auditing under Islamic shariaa is concerned about realization of adding value and preventing harming the community and stakeholders and it involves a review of future looking operation and financial audit, with opinion on the management performance, inefficiency of management in addition to any existing or expected fraud due to suspected transactions against Islamic shariaa law and guidelines by Shariaa board.

6.4.7 Disclosure and Transparency:

The results in table 1.4 revealed that there is a significant difference between Islamic banks and conventional banks with regard to transparency and disclosures. This result support the argument by Ariffin et.al. (2007) who stated that, the investment account holders (IAH) in Islamic Banks require more details regarding types of risks that taken by the bank than depositors in conventional bank. As long as the Islamic bank discloses more information about all types of risks, the Investment account holders (IAH) increase their confidence to invest more with Islamic bank. Additionally, the more transparency and disclosure in following the sharria rules and sharria board, the more is market participant capable of oversight Islamic banks’ activities and understand any potential banks’ risks. Therefore transparency and disclosure in Islamic banks regarding reporting of different types of risks is very critical and important than in conventional bank because of the existence of distinguished type of arrangement such profit and loss sharing deals and arrangements with special attention to unrestricted investment account holders whose have no voting rights about risk taken by the bank.

Based on the above mentioned analysis the researcher accept the third, the fifth and the sixth null hypotheses, However, the researcher reject the second, the fourth, the seventh and the eighth null hypotheses.

7. Conclusion

Effective corporate governance is an effective system that ensures stakeholders right and governs the relationship between board of directors and employees, In addition to guarantee fairness and accountability of the global financial system.

Banks play a critical role in developing economics but without an efficient regulatory system that ensure accountability, transparency and disclosure, the banking system may turn to a distractive institution instead of being a development and constructive institutions for the global economy. That’s why there is an urgent need to highlight the importance of corporate governance dimensions such as effectiveness of the board, supervisory board, shareholders rights, compensation, Audit and Disclosure & transparency, to understand and enhance each item and overall to develop an effective corporate governance system.

The recent global financial crisis explores the deficiency of the international financial system and the fragile of the corporate governance system. This study highlighted that there is a significant difference between Islamic Banks and Conventional Banks with regard to supervisory board Audit and Disclosure & transparency. And during the financial crisis the Islamic Banks with their immunity system absorbed the financial shock and resist the destructive wave of the financial crisis. This could give the regulators a clue to enhance their auditing and disclosure system in addition to restrictive supervisory board that will protect the stakeholder wealth not just the stockholders wealth.

Also, As long as there is no significant difference between Islamic banks and conventional banks regarding compensation system, Islamic bank need to revisit its compensation system and link the compensations and remunerations with consequences and risks associated with executing banking and investment transactions.

References


