

Ownership Structure, Board Characteristics and Bank Performance in the GCC Countries

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Abstract

This paper examines the impact of ownership structure and board characteristics on bank financial performance using data from the six countries in the Gulf Cooperation Council (GCC). Sixty seven banks, conventional and Islamic, are studied. OLS regression is used to depict the effect of board structure, ownership structure, and control variables on the financial performance of the banks. The results of this study reveal that there is a significant relationship between board size, board activism, number of outside directors and Tobin's Q; while return on assets is affected by audit committee and outside directors. However, bank size is the only control variable that has an impact on return on equity and profit margin. Most banks in GCC use "Big 4" audit firms in their efforts to enhance corporate governance practices.

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Keywords: Ownership structure, Board characteristics, Corporate governance, Bank performance, GCC.

1. Introduction

BANK governance has changed tremendously during the last three decades, principally due to bank ownership changes, such as mergers and acquisitions [1]. The worldwide financial crisis of 2008, originating in the United States (US), has been attributed to U.S. banks' excessive risk-taking. Consequently, in order to control such risk and draw people's attention to the agency problem within banks, there are statements made by bankers, central bank officials, and other related authorities, emphasizing the importance of effective corporate governance (CG) in the banking industry since 2008 and until now [2, 3].

The aim of GCC countries is to have a strong financial sector, based on well-established financial companies, in order to keep

pace with international developments and enable the vision of a solid economy that will be recognized internationally. Banks in the GCC countries play a dominant role as financial intermediaries in a region where most companies are non-listed, family-owned enterprises. Banks can play a central role in instilling a culture of good CG in that region, which is so vital for private sector development.

The rest of the paper is organised as follows: the following section provides a theoretical background and hypotheses development. The research methodology is provided in Section 3, followed by the findings and analysis in Section 4; and finally summary & conclusion are provided in Section 5.

2. Theoretical Background and Hypothesis Development

2.1. Ownership Structure

Some studies find that changes in performance are significantly associated with changes in insider ownership [4]. These studies

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Table 1. Population and Samples per Country.

Country	All Bankscop List (Population)	Population (Banks only)	Sample Size
Bahrain	58	29	18
Kuwait	33	10	8
Oman	14	7	7
Qatar	14	7	7
Saudi Arabia	22	12	11
United Arab Emirates	39	19	16
Total	180	84	67

Table 2. Definition and Measurement of Variables.

Variable Symbol	Definition	Measurement
Dependent Variables		
Tobin Q	We used Chung and Pruitt (1994) measure of Q (CPQ) as an approximation of Tobin Q, since it does not require an estimate of the market values of debt and preferred stock	$C-P Q = (MV (CS) + BV (PS) + BV (LTD) + BV (INV) + BV (CL) - BV (CA)) / BV (TA)$
ROA	The amount of return on bank's assets	Net Income divided by Average Total Assets
PM	Profit Margin	Net Income divided by Revenue
ROE	The amount of return on bank's equity	Net Income divided by Average Total Equity
Independent Variables		
OwnCon	Ownership Concentration	Adding up all share ratios of shareholders of the bank who have 5% or more (excluding others)
DirOwn	Director Ownership	Owner Manager = 1; Hired Manager = 0
Brdsize	Board Size	Total number of board members during 2011
Duality	CEO Duality	Duality: If the CEO and Chairman are the same person = 1; If otherwise = 0
BrdNonEx	Number of Non-Executives on Board	Number of non-executive members on the board during 2011
BrdActivism	Board Activism	Number of board meetings held during 2011
AC	Audit Committee	If Audit Committee exists = 1; If it does not = 0
Control Variables		
TYPE	Bank Type	Conventional bank = 1; Islamic = 0
AGE	Age of Bank	Number of years since the bank was established
SIZE	Bank Size	Natural log of total assets

Table 3. OLS Regression Results.

	Model 1 (Dependent Variable Tobin Q)		Model 2 (Dependent Variable PM)		Model 3 (Dependent Variable ROE)		Model 4 (Dependent Variable ROA)	
	Coeff.	t-statistics	Coeff.	t-statistics	Coeff.	t-statistics	Coeff.	t-statistics
Const.	.164	.303	.140	.454	-.031	-.342	.015	.937
Size	-.009	-.218	.053	2.254**	.014	1.983*	-1.390E-5	-.011
OwnCon	-.156	-.819	-.126	-1.164	-.020	-.652	-.011	-1.987*
DirOwn	.087	.486	-.147	-1.439	-.029	-.968	-.008	-1.535
BrdSize	.145	4.336***	-.020	-1.078	-.005	-.947	.000	-.161
Brdactivism	.061	1.807*	.011	.566	.004	.689	-.001	-.931
Ac	.016	.078	.050	.432	-.002	-.071	.011	1.780*
BrdNonEx	-.103	-2.874***	.014	.711	.008	1.339	.002	1.755*
Age	.006	1.470	.002	1.018	.000	.774	-8.699E-6	-.079
Duality	-.055	-.198	-.243	-1.550	-.023	-.516	-.010	-1.198
F-statistics	3.671		2.460		1.921		2.364	
p-value for F- test	0.002		0.026		0.079		0.032	
R-squared	0.472		0.374		0.318		0.365	
adjusted R ²	0.343		0.222		0.153		0.211	
Max VIF	2.774		2.774		2.774		2.774	
*Statistically significant at the 0.10 level								
** Statistically significant at the 0.05 level								
*** Statistically significant at the 0.01 level								

document that the greater the increase in insider ownership, the greater the performance improvement, which is consistent with the alignment of interests hypothesis arising from a larger insider ownership. Similarly, a study find evidence, in a sample of successful bidders in bank acquisitions, of a positive association between bidder returns and the level of insider ownership when the latter exceeds 6% [5].

Research results by [6–8] are also consistent with the view that insider ownership can be an effective tool in reducing agency costs, although they report a non-monotonic relation. This functional form has been related to the observation that, within a certain ownership range, managers may use their equity position to entrench themselves against any disciplining attempts from other monitoring mechanisms. Some studies reveal that boards of directors are likely to have a more positive effect on community bank performance when directors have a significant financial interest in the bank [9].

In developing countries where large concentration of ownership is more evident while the stock markets are weak. In those countries, there is a higher degree of economic uncertainties coupled with weak legal controls and investor protection, and frequent government intervention; all resulting in poor performance [10–12]. In the banking sector in the GCC countries, most ownership and control are substantial family corporate holdings and boards of directors are largely dominated by controlling shareholders, their friends and relatives. Based on the above discussion, the first research hypothesis is:

H₁: There is a significant relationship between ownership structure and bank performance.

2.2. Board Characteristics

Several studies reveal that there is a negative relation between the size of the board and performance [8, 13, 14]. Larger boards seems to be less efficient due to the slow pace of decision making and the difficulty in both arranging board meeting and reaching consensus. It is also argued that the CEO seems to have more dominant power when the board size is too large [13, 15–18]. Some studies report that ROA and ROE are statistically significant and negatively related to board size in European Banks [19]. However, other studies find positive significant relationship between the size of the board and bank performance in Taiwan [20].

Based on the agency perspective, the separation of the roles of CEO from chairman is another crucial monitoring mechanism. CEO duality is problematic from an agency perspective as the CEO seems to get dominant influence on board decisions by chairing the group of people in charge of monitoring and evaluating his performance. This in effect results in weakening the board's independency and may result in ineffective monitoring of management. Therefore, good governance will occur when the two roles of Chairman and CEO are separated [21–24]. Several studies reveal that separating the positions will affect performance posi-

tively [23, 25, 26]. On the other hand, the studies [21, 27] do not find sufficient evidence to support a performance distinction between the separated and combined leadership firms on performance. The discussion above leads us to the second research hypothesis:

H₂: There is a significant relationship between board characteristics and bank performance.

2.3. Both Characteristics of Structure and Board

Some studies aim to compare the OECD CG principles with principles from Islam and declare them compatible; they point out that Islam as applied to business is entirely compatible with CG [28]. Honesty and trust are key ingredients of an effective governance framework [29], and are also basic to ethical behaviour in the Islamic Sharia [30–32]. A study found that there is no significant difference between the United Arab Emirates' national conventional and Islamic banks regarding CG practices [33]. This prompts the third research hypothesis as:

H₃: There is no difference in ownership structure and board characteristics between Islamic and conventional banks.

3. Research Methodology

3.1. The Method

In order to test the hypotheses, quantitative method was used to investigate the effects of ownership structure and board characteristics and other control variables, such as bank size, age and type of banks on bank performance. The bank performance was measured by Tobin's Q, ROA, Profit Margin, and ROE. Bankscope database is used to the top fifty one banks from six GCC countries, as shown in Table 1.

3.2. Sampling and Data Collection

The targeted population is the conventional and Islamic banks operating in the GCC countries which are Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, and United Arab Emirates. Table 1 shows the population and samples selected per country.

3.3. Measurement of variables

For bank performance measurement, the dependent variables that were used are Tobin's Q, ROA, Profit Margin, and ROE. Meanwhile, the independent variables that were used in regard to CG mechanisms are ownership concentration, director ownership, duality, board size, board non executive, board activism, and audit committee. Control variables include bank type, bank age, and bank size. Table 2 shows the definition and measurement of these variables.

4. Finding and Analysis

4.1. Hypotheses Testing

Multiple regressions were used to test the first two hypotheses. For testing the third hypothesis, two-independent samples t-test is adopted. Table 3 provides the results for the following multivariate regression models.

$$\begin{aligned} \text{Tobin's } Q &= \alpha + \beta_1 \cdot \text{OwnCon} + \beta_2 \cdot \text{DirOwn} \\ &+ \beta_3 \cdot \text{Duality} + \beta_4 \cdot \text{Brdsize} \\ &+ \beta_5 \cdot \text{Brdnonex} + \beta_6 \cdot \text{Brdactivism} \\ &+ \beta_7 \cdot \text{Ac} + \beta_8 \cdot \text{Age} + \beta_9 \cdot \text{Size} + \varepsilon \end{aligned} \quad (1)$$

$$\begin{aligned} \text{PM} &= \alpha + \beta_1 \cdot \text{OwnCon} + \beta_2 \cdot \text{DirOwn} \\ &+ \beta_3 \cdot \text{Duality} + \beta_4 \cdot \text{Brdsize} \\ &+ \beta_5 \cdot \text{Brdnonex} + \beta_6 \cdot \text{Brdactivism} \\ &+ \beta_7 \cdot \text{Ac} + \beta_8 \cdot \text{Age} + \beta_9 \cdot \text{Size} + \varepsilon \end{aligned} \quad (2)$$

$$\begin{aligned} \text{ROE} &= \alpha + \beta_1 \cdot \text{OwnCon} + \beta_2 \cdot \text{DirOwn} \\ &+ \beta_3 \cdot \text{Duality} + \beta_4 \cdot \text{Brdsize} \\ &+ \beta_5 \cdot \text{Brdnonex} + \beta_6 \cdot \text{Brdactivism} \\ &+ \beta_7 \cdot \text{Ac} + \beta_8 \cdot \text{Age} + \beta_9 \cdot \text{Size} + \varepsilon \end{aligned} \quad (3)$$

$$\begin{aligned} \text{ROA} &= \alpha + \beta_1 \cdot \text{OwnCon} + \beta_2 \cdot \text{DirOwn} \\ &+ \beta_3 \cdot \text{Duality} + \beta_4 \cdot \text{Brdsize} \\ &+ \beta_5 \cdot \text{Brdnonex} + \beta_6 \cdot \text{Brdactivism} \\ &+ \beta_7 \cdot \text{Ac} + \beta_8 \cdot \text{Age} + \beta_9 \cdot \text{Size} + \varepsilon \end{aligned} \quad (4)$$

Model 1 investigates the relationships between bank performance (*Tobin's Q*) and the variables of interest. The R^2 is 0.472 and the model appears highly significant ($F = 3.671$, $p = 0.002$). Board size and board activism appear to have an effect on *Tobin's Q*. These results on board size are consistent with the results of bank study in Taiwan [20] and the US [34], however they are inconsistent with previous studies [13, 15–19, 35]. Therefore, Board non-executive has an effect on *Tobin's Q*, where the estimated coefficient is negative and statistically significant at 1% level. This result is consistent with the finding of [35–37].

Model 2 examines the relationships between profit margin (PM) and bank size, bank age, and CG variables. Only bank size appears to have an effect on PM, where the estimated coefficient is positive and statistically significant at 5% level. The results are consistent with the findings of [38].

Model 3 examines the relationships between return on equity (ROE) and bank size, bank age, and CG variables. Bank size only appears to have an effect on ROE, where the estimated coefficient is positive and statistically significant at 10% level. This result may possibly reflect an independent source of value creation due to market power and economies of scale and scope [39].

Finally, Model 4 investigates the relationships between bank performance (ROA) and bank size, bank age, and CG variables. Board non-executive appears to have an effect on ROA, where the

estimated coefficients are positive and statistically significant at 10% level. This result is consistent with previous studies [40, 41].

The independent-samples T-test was used to test the difference between Islamic and conventional banks in terms of ownership and board characteristics.

The interpretation of the two-stage independent t-test result for ownership concentration reveals that Islamic banks are not significantly different from conventional banks in using ownership concentration.

The interpretation of the two-stage independent t-test result for director ownership, duality, board size, board non-executive, board activism, and audit committee reveals that Islamic banks are not significantly different from conventional banks in terms of ownership structure and board characteristics except for board size. The results agree to great extent with the findings of [33].

5. Summary and Conclusion

With exception to board size, the results reveal that there are no significant differences between Islamic and conventional banks in GCC countries in terms of ownership structure and board characteristics. The study also reveals that most of the banks in GCC countries employ “Big 4” audit banks which can lead to enhancing CG practices.

The results reveal that only ownership structure variable having an impact on bank financial performance is ownership concentration where there is a negative relationship. This can be explained by the fact that most ownership and control in GCC countries are substantially in family corporate holdings which are coupled with weak legal controls and investor protection and hence undermine the principles of good CG. This leads us to conclude that high concentration of ownership in the banking sector in emerging economies has negative impact on performance, while board size, board activism, and audit committee as part of the board characteristics have the positive impact on financial performance in GCC banks.

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