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Corporate Governance Mechanisms Adopted by UAE National Commercial Banks

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Abstract

The purpose of this paper is to enhance understanding of corporate governance (CG) in the banking sector and to explore the existence and practice of corporate governance mechanisms in United Arab Emirates (UAE) national commercial banks. More specifically, the paper is targeted to examine whether the mechanisms forced by the law; Board of Directors, Auditors, Audit Committee and Credit Committee, are used by UAE banks and if the majority of these banks choose independent boards. This descriptive study conducted on all UAE national commercial banks over the year 2014, indicates that most of the corporate governance mechanisms adopted by banks are those imposed by laws and regulations, all banks have a board of directors, an auditor, an audit committee and an executive committee. However, most of these banks have other committees voluntarily created to enhance corporate governance systems in these banks, such as nomination, numeration and risk management committees. The domination of non-executive directors (NEDs) on the board and the lack of board duality reflect that the banks are increasingly adopting a more independent board of directors. Finally, the study reveals the importance of internal mechanisms vis-à-vis external norms. The paper provides a comprehensive study to help understand key mechanisms of CG, particular used by UAE banks. Therefore, it helps policy makers, shareholders and other stakeholders to maintain effective corporate governance systems which enhance the effectiveness of financial institutions.

JEL classification numbers: G3
Keywords: Corporate Governance, Corporate Governance Mechanisms, Board of Directors, Audit Committee, Auditors, Executive Committee, UAE National Commercial Banks.

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1 Introduction

Corporate governance has been recognized as central to the success of companies at both domestic and international levels. According to the Organization on Economic Co-Operation and Development (OECD), corporate governance expands to include state-owned enterprises (SOEs) and private companies, both formal and informal, where it governs the relationship between those who manage companies and all others who provide resources in the companies. CG encompasses the existence of a set of relationships between a company's management, the board of directors, its shareholders and other stakeholders. At the company's level, good CG motivates the management of an institution to pursue the objectives and act in accordance with the interests of shareholders, and facilitates monitoring. At the state level, effective corporate governance systems provide a level of confidence necessary in the market economy. Due to the importance of this theme, the literature review includes a diversity of studies on CG, including qualitative, conceptual, theoretical and empirical studies (Manolescu et al. [1]).

In general, the misalignment of interests of managers, shareholders and other stakeholders may create agency problems. In particular, the separation of functions between managers and shareholders leads to arising a conflict of interest between them, since the former will be a self-interest optimizer; where managers will pursue the objectives and act in accordance with maximizing their benefits and/or minimizing their risk at the expense of those who provider resources (Jensen and Meckling [2]; Sheifer and Vishny [3]). To reduce these agency problems, several mechanisms have been used: what is known as CG. The final goal of CG is to enhance the company's economic efficiency and strengthen its growth, increase investors' confidence, provide a structure for setting objectives that will serve the interests of the shareholders and other stakeholders, and determine the mechanisms that can be used to achieve these objectives and manage their accomplishment (OECD [4]).

Good governance is central to all stakeholders, particularly, shareholders. CG is related to the controlling of the activity. While controlling of the corporate sector can be termed as CG. But the implementation of CG is not that much simple as it may appear. It is very broad theme and it comprises much debate. No doubt CG is recently emerged concept and has taken the attention of countries, companies and managers, but its needs are in urgent state. CG is the practice, which requires transparency, accountability and good performance from the corporate executives. It has its strong base from the internal management of company to the shareholders' value as well as corporate social responsibility (Mehta and Chandani [5]).

Enterprises take different forms across different countries and economies, and therefore it is difficult to develop a uniform thinking on the theme of CG. The literature review on banks' corporate governance has been given less attention and has not been sufficiently considered despite its importance. Additionally, the recent global financial and banking crises have revealed the importance of enhancing understanding of bank governance (Pathan and Skully [6]). In this context, this study is concerned with CG in the banking sector, which may due to three considerations:

-The contribution of banks is central to any economy. They acquire publics' savings in the form of deposits, provide means of payment for goods and services and finance the development of businesses. Accordingly, banks' corporate governance concern not only shareholders and managers, but also customers, depositors and creditors. Therefore, banking governance is viewed by some authors as a public interest (Damak [7]).

-The banking sector is characterized by unique agencies problems vis-à-vis other business sectors and industries. Additionally, the activity in the banking industry is characterized by the complexity of the operations, which increases information asymmetry and weakens the stakeholders' ability to monitor the decisions of bank managers. These aspects lead to the fact that banks' corporate governance has certain distinctive features and requires the implementation of more specific and complex banking corporate governance mechanisms (Ţurleai et al. [8]).
-The banking sector is highly regulated industry compared with other industries, due to the responsibility of banks for protecting the rights of the depositors, ensuring the stability of the payment system and reducing systemic risk. Therefore, it is important to explore corporate governance mechanisms used by banks and to verify if these mechanisms forced by laws and regulations or voluntarily adopted by banks.

The paper is structured around seven sections. Section one starts with demonstrating theoretical framework of corporate governance mechanisms, including agency problems and CG, defining CG, and finally highlighting corporate governance mechanisms. Section two is concerned with reviewing corporate governance literature in general and banks' corporate governance literature in particular. Section three describes research problem, research methodology and research limitations. The regulatory framework of the UAE banking sector is addressed in section four. Corporate governance mechanisms adopted by UAE national commercial banks, including ownership characteristics, board of directors' characteristics, committee structure, and interactions between internal and external mechanisms are analyzed in section five. Finally, research conclusions and recommendations are revealed in section six. Moreover, the paper concludes by identifying some main policy and research issues that require further study on CG in section seven.

2 Theoretical Framework of corporate Governance Mechanisms

The following section highlights agency problems and corporate governance theories or models and explores several concepts of CG from different perspectives. Furthermore, the internal and external corporate governance mechanisms are highlighted in this section. As per Shleifer and Vishney [9], the agency theory of CG focuses on how shareholders can ensure that managers pursue the shareholders' objectives. In most countries, companies' managers are legally responsible to the shareholders. Hence, the contrast between the legal rights of shareholders and the actual control of managers led to the development of agency approach to corporate governance (Jensen and Meckling [2]; Fama and Jensen, 1983a,b [10]; and Hart [11]). However, there are other perspectives or models addressing the possibility of aligning the interests of managers, owners, and other stakeholders.

2.1 Agency Problems and Corporate Governance Models

The separation of ownership and control can produce agency costs arising from the misalignment of the interests of the managers and owners of companies, since the former will take decisions that maximize their profit and/or minimize their risk at the expense of

the later. In ideal situations, when there is no agency problem, each group is motivated to maximize profit and minimize cost, which consequently maximizes shareholder value. But, in the real world, there are agency problems and complete contracts are infeasible owing to bounded rationality and information asymmetries (Rachagan and Satkunasingam [12]).Several factors allow the managers to optimize their own benefits; particularly they are better informed than owners about the nature of the business, and therefore the question of opportunism will be raised. Opportunism of managers is recognized by handling private information and managing their reputation by choosing the projects that generate a maximum of the short term profits. The managers may also take advantage from the lack of transparency to communicate only information that serves their interests. Hence, the managers can preserve their positions from the competition in the labor market. In this context, (Stieglitz and Edling [13]) propose a model in which managers enhance the investments of the company to increase information asymmetry. Similarly, (Morck et al.[14]) indicated that the manager engages the company in several acquisitions to increase their own personal benefits, even if these acquisitions create negative consequences for the company.

In general, there are three agency problems arising in companies. The first involves the conflict between the company's owners and its managers as indicated above. The second agency problem encompasses the conflict between the shareholders who own the majority or controlling interest in the company and the minority or non-controlling shareholders. In this case, the non-controlling shareholders are the principals and the controlling shareholders are the agents, and the problem is to assure that the later are acting in the best interests of the former. The third agency problem includes the conflict between the company and the other parties who have interests in or impact on the company, such as creditors, employees, customers and other stakeholders. Here, the problem is to assure that the company as agent does not behave opportunistically by exploiting these other principals ((Rachagan and Satkunasingam [12]). Furthermore, agency problems can take the forms of adverse selection and moral hazard. Adverse selection appears when the principal employs an agent who is less able, committed, productive, or ethical, or whose interests are entirely conflicting with those of the principals. Moral hazard can arise due to the lack of effort on the part of the agent after hiring him or her. This risk can take different forms, such as commission or omission of actions and the consumption of perks ((Rachagan and Satkunasingam [12]). This paper will concentrate on the agency problem of the conflict between shareholders and managers.

CG encompasses the legal, institutional, and cultural mechanisms that enable shareholders to limit agency problems (John and Senbet [15]; Peace and Osmond [16]). Good corporate governance therefore plays a critical role in solving these agency problems by enabling shareholders to exercise control over corporate executives, align the interests of these groups and lead to superior performance (Jensen and Meckling [2]; Fama and Jensen [10]; Daily and Dalton[17]).Consequently, different corporate governance mechanisms either internal or external to the company should be employed in order to align the interests of agents and principals (Bozec and Bozec [18]).

As per literature review, several corporate governance theories have been developed, including the shareholder model or the agency theory, which gives priority to the interests of the shareholders (as described above), the stakeholders model, which recognizes the interests of employees, managers, suppliers, customers and the community, and the stewardship model which claims that the conflict of interests between managers and shareholders can be avoided (Jeffers [19]; Donker and Zahir [20]; Letza et al.[21]).

Hence, assumptions made in agency theory or shareholder model about individualistic utility and opportunistic activity motivation on the part of mangers resulting in conflict of interest between shareholders and managers may not hold for all companies; and therefore, exclusive reliance on agency theory is undesirable, because the theory pays no attention to the complexities of organizational life. Stewardship theory and stakeholder theory are briefly described in the following part.

Stewardship theory: The stewardship theory which stems from sociology and psychology claims that managers or agents are not motivated by opportunistic interests but rather they are stewards and behave in the best interests of shareholders or principals. Unlike the agency theory which claims that conflict of interest between managers and shareholders is inevitable unless appropriate corporate governance mechanisms are used to align the interests of managers and shareholders (Jensen and Meckling [2]). The stewardship perspective indicates that stewards (managers) will be satisfied and motivated when organizational success is attained even at the expense of their own individual motives. Furthermore, while the agency theory suggests that shareholder interests will be protected by avoiding the board duality, stewardship theory emphasizes that shareholder interests will be maximized by appointing the same person to the two posts to provide more responsibility and autonomy to the CEO as a steward in the company (Donaldson and Davis [22]).

Stakeholder theory: The stakeholder theory originated from the management discipline and gradually developed to include corporate accountability to a broad range of internal and external stakeholders, such as employees, managers, directors, owners, creditors, customers, suppliers, and others. As opposite to the agency theory, where managers are responsible for maximizing shareholders' motives, the stakeholder theory argues that managers in companies are not only responsible for satisfying the interests of shareholders but also for acting in the best interests of a broad range of stakeholders, including the society as whole. According to stakeholder theory decisions made regarding the company affect and affected by different parties in addition to owners of the company. Therefore, the managers should on the one hand act in accordance with stakeholders' interests in order to ensure their rights and their participation in decision making and on the other hand the management must act as the stockholder’s agent to ensure the survival of the company to maintain the long term stakes of each group (Fontaine et al. [23]).

2.2 Defining Corporate Governance

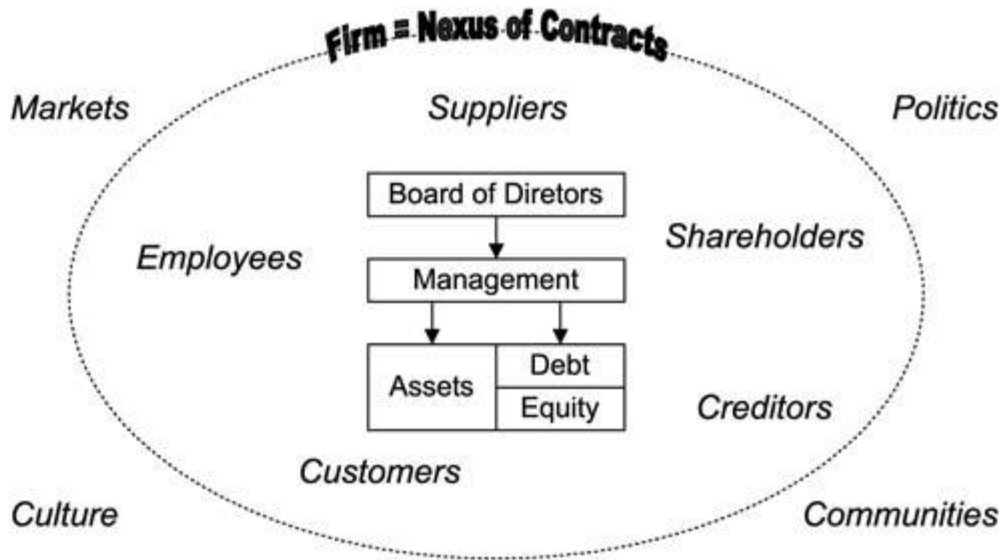
CG definitions differ widely depending on political, economic and cultural differences. They can be categorized in two groups; the first set of definitions focuses on behavioral patterns or the actual behavior of companies, in terms of measures such as performance, efficiency, growth, financial structure, and dealing with shareholders and other stakeholders. The second group focuses on the normative framework which involves the rules under which companies are operating, including the rules derived from the legal system, financial markets, and labor markets. It would be more appropriate for studies of single countries or companies within a country to use the first set of definitions. It considers such matters as how boards of directors are functioning, the role of executive compensation in directing and motivating managers to act in accordance with the best interests of shareholders, the relationship between labor policies and company performance, and the role of shareholders. While, for comparative studies, the second set

of definitions could be the most appropriate. It examines how differences in the normative framework affect the behavioral patterns of firms, investors, and others (Claessens [24]).

The exercise of CG can be viewed from five different perspectives (Van den Berghe and Carchon [25]; Sison [26]). Firstly, CG can be understood at the level of the board of directors; secondly, it can be understood at the level of the so-called *"corporate governance tripod"* comprising shareholders, directors and management; thirdly, from the viewpoint of a company's direct stakeholders, including employees, suppliers and customers; fourthly, from the viewpoint of a company's indirect stakeholders, including the government, the environment and the society as a whole. Finally, CG can be understood from a global perspective that considers the economic, legal and cultural environments in which an organization works and competes in (Ţurleai et al. [8]). In short, CG may be dealt with in a narrow or a broad manner. From a narrow perspective, it is limited to the relationship between management and shareholders. From a broader perspective, CG may be considered as a mesh of relationships between management and all those who have interests in or impact on the company, such as shareholders, employees, customers, suppliers etc. The broader perspective of CG emphasizes a broader level of accountability to shareholders and the whole society, future generations and the natural world (Solomon [27]). Such a broad view on CG is articulated by Sison [26])) "*as the system of checks and balances, both internal and external to companies, which pushes companies fulfilling their accountability to all stakeholders and act in a socially accepted manner*"**.**

By incorporating the community in which companies work and compete in, the political environment, laws and regulations, and more generally the markets in which companies are involved; Figures 1,2 reflects the broad perspective of CG (Jensen [81]). A somewhat broader definition would be to define CG as a set of mechanisms through which companies operate when ownership is separated from management. This is close to the definition used by Adrian Cadbury, head of the Committee on the Financial Aspects of Corporate Governance in the United Kingdom: *"Corporate governance is the system by which companies are directed and controlled"* (Cadbury Committee, [28]).

Figure 1: Corporate Governance



Source: Gillan [29]

Figure 2: Five Elements of Corporate Governance to Manage Strategic Risk

Source: Drew et al. (2006)

Based on the revision of the foregoing different corporate governance definitions and expectations, it can be said that these differences reflect different theoretical frameworks or models. For instance, the definitions that are articulated by Cadbury [28]; Shleifer and

Vishny [9]) indicated that CG is associated with both ownership and control, and that it is targeted to maximizing the benefits of the shareholders. These definitions are associated with the agency theory or shareholders model. Alternatively, the definitions of (OECD [4]; Solomon [27]) are directed by the stakeholder theory, which outlines the rights and responsibilities of each major group of stakeholders in a company, and explains rules and procedures for making decisions about corporate affairs. Stakeholder theory ensures that individuals that are both inside and outside a company include owners, creditors, employees, suppliers, customers, publics, governments or other individuals or groups affect or be affected by the company actions and therefore the companies are responsible to carry out the actions that benefit them and benefit the whole society (Shahin and Zairi [31]).
This paper is adopts the definitions that reflect the agency theory or shareholders model, particularly the Cadbury definition of corporate governance as: “a system by which companies are directed and controlled”, which highlights the main players’ roles in an organization, including shareholders, the board of directors as well as the auditor (Cadbury [28]).

2.3 Corporate Governance Mechanisms

Corporate governance mechanisms can be defined as a set of tools that explain the powers, influence management decisions, govern the behavior and limit discretionary space of managers (Damak [7]). They are means or control structures used by the principals to align the interests of principals and agents and to monitor and control agents. The purpose of these governance mechanisms is to limit the scope and frequency of agency costs and to ensure that agents act in accordance with the best interests of their principals (Hill and Jones [32]). There are two distinct types of corporate governance mechanisms: internal and external mechanisms (Hill and Jones [33]; Damak [7]:

2.3.1 Internal Corporate Governance Mechanisms

Internal mechanisms are the internal means used by companies which can motivate managers to maximize the shareholders' value. These means include, in particular, board of directors, audit committees, auditor, ownership structure, stock-based compensation supervisory board.
(A) The Board of Directors: It is the backbone of the corporate governance system in companies across most of countries. The board members are directly elected by shareholders and they represent shareholders' interests in the company. Hence, the board is responsible for monitoring corporate strategy decisions and controlling management activities on behalf of shareholders, ensuring that managers pursue strategies that are in the best interests of stockholders. In addition, the board is legally accountable for the company's actions and is authorized to hire, fire, and compensate corporate executives, including most importantly the CEO. Furthermore, the board is also responsible for the verification of financial reliability, the verification of compliance with laws and regulations and the reduction of information asymmetry between shareholders and managers (Hill and Jones [32]).
The typical board of directors consists of a mix of inside and outside directors. Inside directors are required on the board because they have valuable information about the company's activities. While, outside directors who are professional and hold positions on

the boards of several companies are needed to bring objectivity to the monitoring and evaluation processes, particularly their needs to maintain a reputation as independent directors gives them an incentive to carry out their tasks as objectively and effectively as possible (Fama and Jensen [10]).

(B) Board Committees: Committees are supplementary components to the board of directors. They are required to conduct particular activities or tasks that are delegated by the board. These committees can be mandatory by the laws and regulations and can be recommended by the board depending on nature of business sectors in which companies work and compete. In countries where the creation of committees is mandated by laws or regulations, the number and structure of the committees differ from a country to another. Committees most commonly provided are: the audit committee; the nomination committee, the executive committee and the remuneration committee.

(C) Financial Statements and Auditors: Public stock companies (PSCs) in most countries are required to file quarterly and annual reports aiming to provide consistent, detailed, and accurate information about how efficiently and effectively the managers are running the company. This financial information must be audited by an independent and accredited accounting firm or external auditor. If the system works as projected, shareholders can have a lot of faith that the information contained in financial statements accurately reflects the company's financial position (Hill and Jones [32]).The role of the auditor is to provide shareholders with more developed and more relevant information. The internal audit function plays a crucial role in the ongoing maintenance and assessment of a bank's internal control, risk management and governance systems and processes–areas in which supervisory authorities have a keen interest"(Basel Committee on Banking Supervision [71]; Damak [7]).

(D) Ownership Structure: a means of controlling the relations between shareholders and managers. The ownership structure is an effective means of control of management executives. The ownership structure provides the basis for efficient monitoring system, namely, an incentive controller to carry out their functions, as well as cost control. According to the agency theory two components of the ownership structure, the concentration of capital and the nature of the shareholders may be the cause of the performance of a company.

(E) Stock-Based Compensation: As per the agency theory, one of the best mechanisms to limit the scope of the agency problems is to encourage agents or management to behave in accordance with the best interests of principals or shareholders through pay-for performance system. Where, shareholders can motivate top managers to pursue strategies that maximize a company's long term profitability and profit growth, and thus the stocks' value, by associating managers' pay to the performance of the stock price. The common pay-for performance system is to grant managers stock options; the right to buy the company's shares at a predetermined price at some points in the future, usually within ten years of the grant date. The idea behind stock options is to motivate managers to pursue strategies that increase the share price of the company, and therefore they will also increase the value of their own stock options (Hill and Jones [32]).

2.3.2 External Corporate Governance Mechanisms

Given the imperfections of internal corporate governance mechanisms used by companies, there is another type of control that can contribute in managing the potential conflict of interests that may arise between shareholders and managers. This control is

performed through the market including: financial market, market goods and services, labor market managers.

(A) The Financial Market

The role of the financial market in controlling the company's management is becoming more important with the development of stock markets. Certainly, there is a direct relationship between efficiency, effectiveness of managers and the company's market value. If the management strategy is likely to risk the benefits of shareholders, they still have options to sell their shares. Accordingly, if they start doing so in large numbers, the value of the company's shares will decrease and may become an attractive acquisition target and runs the risk of being acquired by another company, against the wishes of the target company's management. Hence, senior managers typically lose their independence and probably face therefore the risk of being replaced after the takeover of a new investor. So the threat of takeover can constraint management actions and limit the agency costs. The takeover constraint limits the extent to which managers pursue strategies and take actions that fulfill their own interests at the expense of their shareholders (Hill and Jones [32]).

(B) The Market of Goods and Services

Competition in the market of goods and services can depress senior managers of a company who act in accordance with their own individual motives at the expense of shareholders' interests. In reality, any competitive market leads the managers to capitalize on the company's resources and to play a preventive role against the failure of the company. However, the effectiveness of this mechanism of control is limited (Damak [7]).

(C) The Labor Market for Managers

The labor market is an effective system of control because it addresses the importance of human capital in management. Managers are constantly faced with the pressure of the labor market. This market allows for the selection of the most competent managers based on their merit through the competition which exists between external and internal managers.

3 Literature Review on Corporate Governance

3.1 Literatures Review on Corporate Governance

Table 1: Finding of Previous Literature on Corporate Governance

Authors	Key Findings
Sánchez [33]	This study examined the effectiveness of Spanish corporate governance by analyzing the impact of board characteristics, including board size, board independence, board reputation, board diversity and board activity on efficiency. Results indicated that business efficiency is associated with heterogeneous boards with a limited number of directorships per director and with a limited activity specified in a reduced number of annual board meetings with a higher number of specialized committees.
(Bozec and Dia [34]; Destefanis and Sena [35]; Lin et al. [36]),	These studies investigated the effectiveness of CG by analyzing the relationship between firm performance and the production process: technical efficiency, since the core of a business organization is its operation function—the process of transforming inputs into outputs—and efficiency is very important.
Claessens [24]	This study investigated the relationship between CG and economic development and well-being. Results revealed that better corporate frameworks benefit companies through greater access to financing, lower cost of capital, better firm performance, and more favorable treatment of all stakeholders.
Shahin, A. and Zairi [31]	The study demonstrated models of CG and the associated elements affecting corporate social responsibility (CSR).It addressed the integration of CSR into management systems through a framework as a process-based management system and studied the role of leadership style for socially responsible companies. Results revealed that CG includes different internal and external factors which influence firms' management.
Williams and Mas [37]	This study examined the fundamental differences in European Union (EU) country approaches to CG and business ethics given the conformity forced by the EU's recent standardization directives. Results revealed that EU countries are adapting their governance and ethics practices depending on their own technical, cultural, and political process, creating changes to the directive, particularly in the implementation phase.
Mehta and Chandani [5]	This study investigated Indian corporate practices in terms of CG with board of directors' parameters and evaluated the same with the international board. Results emphasized the governance pattern among Indian corporate sector.
Needles [38]	This study examined Turkish high performing companies and explored their measures of CG compared to their counterparts? Results revealed that Turkish companies, including high and lower performing companies scored moderate measures of CG. However, high performing companies scored higher norms of CG than comparable companies.
Needles [38]	This study investigated whether firms that exhibit strong governance benefit from higher overall firm credit ratings relative to firms with weak governance. Results revealed that credit ratings are negatively associated with the number of block holders and CEO power, and positively related to takeover defenses, accrual quality, earnings timeliness, board independence, board stock ownership, and board expertise.
(Banerjee et al. [39]; Sami et al.[40])	These studies analyzed the compliance of HPCs as well as ORDs with good corporate governance measures. Results indicated that HPCs scored higher measures of CG than ORDs, however the results did not strongly support that Indian HPCs apply superior corporate governance practices. They also found that CG measures are positively and significantly associated with company performance and valuation.
(Al Saeed [41]; Wen and Shao [42];	These studies examined the explanatory power of corporate governance mechanisms on the wealth effect of firms' new product strategies. Results indicated that board size and independence, audit committee independence, CEO equity-based pay, analyst following and shareholder rights are all of significance in explaining the variations in the wealth effect of new product introductions.

	Results also revealed that new product strategies launched by firms with better corporate governance mechanisms tend to receive higher stock market valuations than those of firms with poorer governance mechanisms.
Lawrence and Marcus [43]	They found that the governance provisions recently mandated by the U.S. stock exchanges are less closely linked to firm operating performance than are those not so mandated.
Mahmud et al. [44]	This study examined how the relation between CG and auditor choice may be affected by the strength of legal environment. Results revealed that firm-level governance scores are positively related to the firm's auditor choice.
Mohamad and Sulong [45]	The study examined the relationship between corporate governance mechanisms and the level of disclosure of Malaysian listed companies. Results revealed that there is some evidence support the assumption that companies with higher percentage of family members on boards have significant lower level of disclosure in their annual reports.
Alzoubi and Selamat [46]	This paper investigated the relationship between CG and earning management. findings showed that the companies with effective characteristics of board and audit committee are less likely to allow earning management because opportunistic earning's cause uncertainty about the economic value of a company.
Htayand Salman [47]	This study examined UK corporate governance codes. Results revealed that the existing code is not really comprehensive enough to cover the responsibility of board of directors towards the risk management, transparency of information, competency of directors and role of institutional ownership and understanding of stakeholders' interests.
Leng and Ding [48]	This paper investigated the influence of corporate governance structure on internal control disclosure in Chinese listed non-financial companies. Results indicated that internal control disclosure is positively associated with directors' remuneration, the duality of CEO, directors' education level and supervisors' education level. Also, findings indicated that internal control disclosure is not significantly related to ownership structure, board size, the board independence.
Al-Malkawi and Pillai [49]	This study investigated the relationship between internal corporate governance mechanisms and company performance. Results revealed that the smaller board size, non-existence of duality and favorable dividend mechanisms are effective internal governance mechanisms affecting company performance. Also, results found that there is no evidence on the relationship between leverage and institutional ownership as internal governance mechanisms influencing agency cost and company performance.
Rachagan and Satkunasingam [12]	This study investigated the corporate governance practices of Malaysian SMEs. Results revealed that current prohibitive models of law are not desirable as they have encouraged compliance with the letter but not the spirit of the law.

3.2 Literatures Review on Corporate Governance in the Banking Sector

Table 2: Finding of Previous Literature on Corporate Governance in the Banking Sector

Authors	Key Findings
Ţurleai et al. [8]	This study aimed to define CG in the banking context; to analyze the role and significance of the banking sector; and to explore the characteristics of corporate governance in the banking sector and to emphasize that there is and it should be a relationship of complementarities between the main corporate governance mechanisms, including internal audit, audit committee, and external audit.
(Aboagye and Otieku [50]; Abraham et al. [51]; Handley-Schachler et al. [52]; Nathan and Ribière [53]; Jamali et al. [54])	These studies investigated the relationship between banks' corporate governance and their performance; the relationship between the corporate governance of banks and the financial reporting process of these banks; the association between corporate governance failure and financial problems in the banking sector etc. Findings emphasized, among others, the uniqueness of the banking sector.
Al Saeed [41]	The study explored the degree of compliance with the OECD's principles of corporate governance on the part of Jordanian banks. Results found that the Jordanian banks comply with the OECD principles of corporate governance, particularly with regard to the role of stakeholders in CG and disclosure and transparency categories.
(Al Saeed [41]; Bawaneh [55])	The paper explored how Jordanian banks are influenced by the CG requirements released by Basel Committee on Banking Supervision (BCBS) and OECD. Results revealed that Jordanian banks comply with CG requirements by acting in accordance with Jordan Central Bank corporate governance guidelines and requirements which are based on BCBS and OECD principles of corporate governance.
(Bawaneh [55]; Abu Risheh and Al-Sa'eed [56])	This study supported the above mentioned studies with regard to the compliance of the banking sector of Jordan with the OECD principles of corporate governance. Also, results found that the banking sector of Jordan is complying with corporate governance and disclosure which enhance the quality of financial reporting.
Ţurleai et al. [8]	The study investigated the role of the disclosure on corporate governance in major Australian banks. Results indicated the subjectivity of financial reports and the inability of these reports to present an accurate depiction of reality.
Mullineux [57]	The study investigated the implications of the banks fiduciary duty to their depositors and the government's fiscal duty to taxpayers for the corporate governance of banks. Results revealed that for good corporate governance of banks, regulation needs to balance the interests of depositors and taxpayers with those of the shareholders.
Fanta et al. [58]	The study examined the relationship between selected internal and external corporate governance mechanisms, and bank performance as measured by ROE and ROA. Results indicated that there is a significant negative relationship between board size and board audit committee on one hand and bank performance. While there is a significant positive relationship between bank size and capital adequacy ratio on one hand bank performance on the other hand.
Al-Hawary [59]	This study investigated the effect of CG on the performance of Jordanian commercial banks. Results indicated that CEO duality, board independence, ownership concentration, and capital adequacy had statistically significant positive effect on bank performance, while leverage had statistically significant negative effect on performance.
Sunday [60]	This study examined the relationship between CG and bank performance in Nigeria. Findings found that board and CEO duality had a positive effect on bank performance.
Kiel and Nicholson [61]	The study analyzed the relationship between board composition and corporate performance in Australian listed companies. Findings revealed that board size and the proportion of executive directors were significantly positively associated with market-based measure of company performance.
Tandelilin et al. [62]	The study investigated the relationship between CG, risk management, and bank

	performance in Indonesian banks. Findings revealed that risk management had significant effect on bank performance, and the relationship between CG and bank performance are affected by the type of bank ownership.
Kim and Rasiah [63]	The study examined the relationship between CG and bank performance in Malaysia. Findings indicated that foreign-owned banks had better corporate governance practices than domestically owned private banks.
(Sunday [60]; Kiel and Nicholson [61]; Dallas [64])	These studies examined the effects of internal corporate governance, such as board characteristics including its size, independence, structure, activity, and remuneration on banks' performance. Results indicated some evidence that the size of the board can be an important governance consideration and the optimal size of board of directors should be established for good corporate governance as well as firm performance.
Inam and Mukhtar [65]	This study analyzed the effects of CG on banks' performance in Pakistan. Results revealed that banks with good corporate governance showed better performance compared to banks with poorer corporate governance.

4 Research Problem, Methodology and Limitations

4.1 Research Questions

CG plays a critical role in directing and controlling management strategies, policies, decisions and actions to be in consistent with the shareholders' objectives and motives. Governance has been recognized as one of the main research trends that affect all types of companies and banks in particular. Despite the importance of corporate governance, empirical research in this area so far has been limited. This research aims to demonstrate the importance of CG particularly for financial institutions and to explore the specific corporate governance mechanisms used by the participating banks. The research problem is to explore the corporate governance mechanisms most commonly adopted by UAE national commercial banks. This study therefore aims to examine empirically the existence of certain corporate governance mechanisms in UAE banks. More specifically, this study seeks to address the following questions:
1. Which corporate governance mechanisms used by UAE national commercial banks either forced by the law or opted for voluntarily by these banks.
2. To what degree UAE banks' boards of directors are independent.

4.2 Research Methodology

To tackle the above questions, a qualitative research used to conduct a detailed analysis of UAE banks corporate governance structures or norms provided by annual reports and other materials, together with a review of other relevant literature, particularly on CG in UAE banks. More specifically, in order to explore the specific corporate governance norms or mechanisms used by UAE national commercial banks that include those mechanisms forced by the law and others decided on voluntarily by these institutions. In addition to analyze the degree to which the participating banks' boards of directors are independent, annual reports of the participating banks are used as the data source. Furthermore, All available documentation materials are investigated, including UAE Central Bank' publications and related documentations highlighting corporate governance in UAE companies such as the Law of Commercial Code companies. Use of multiple-

informants and use of archival data helped in crosschecking relevant information and verifying the reliability of data.
For the purpose of the study, all national commercial banks in 2014 were taken from the list of UAE national banks, which comprise eight Islamic banks and fifteen commercial banks. Islamic banks were excluded from the study along with 3 commercial banks due to the lack of comprehensive information required. Table: 3 depicts the UAE national commercial banks subject to this study.
The study involved the analysis of annual reports of the banks stated bellow for the year 2014. Additionally, other information has manually collected from annual reports and the websites of these banks which were also consulted for specific issues such as relations with shareholders.

Table 3: Investigated UAE National Commercial Banks in 2014
(Public Stock Companies-P.S.C)

NO.	Banks	Total Equity (AED)
B1	National Bank of Abu Dhabi (NBAD)	34.7 billion
B2	National Bank of Umm-Al Qaiwain	3.7 billion
B3	RAK Bank (the National Bank of Ras Al Khaimah)	6.5 billion
B4	Bank of Sharjah	4.2 billion
B5	Emirates NBD Bank	41.7 billion
B6	Commercial Bank of Dubai	7.554 billion
B7	First Gulf Bank (FGB)	31.7 billion
B8	Mashreq Bank	15.120 billion
B9	National Bank of Fujairah	3.029 billion
B10	Union National Bank	15.337 billion
B11	Abu Dhabi Commercial Bank (ADCB)	24.82 billion
B12	Invest Bank	2.610 billion

Source: (UAE Banks Federation, Annual Report [66]; Emirates Banks Association, National Banks [67])

4.3 Research Limitations

This study is limited to explore the existence and practice of corporate governance mechanisms and the board independence in UAE national commercial banks. Hence, corporate governance structures or norms are neither investigated in UAE Islamic banks nor in foreign banks working in the UAE. In addition to, external governance mechanisms opted for by UAE national commercial banks are not examined due to the lack of information on these external mechanisms in most of banks' annual reports. Finally, the actual behavior of banks, in terms of such measures as performance, efficiency, growth, financial structure, transparency, accountability and disclosure are not examined in this study.

5 Regulatory Framework of the UAE Banking Sector

The following section addresses the role and features of the banking sector, CG guidelines for UAE banks' boards of directors.

5.1 Role and Features of the Banking Industry

The banking sector is of great importance for a country's economy. The foundation of a highly developed and capital-intensive economy is considered to be a sound banking industry. All industries in any economy can be significantly affected by disorders in the banking industry. However, there are other economic areas with systemic relevance such as the transport or the energy sector. But in no other sector are the interdependencies and the potential consequences of the individual corporate collapses as far-reaching and unforeseeable as in the financial sector (Turleai et al. [8]).

In most if not all countries, loans from banks are the main source of external finance for corporations. Levine [68] emphasizes also the significance of banks for industrial expansion, the corporate governance of companies, and capital allocation. The efficient mobilization and allocation of funds by banks lower the cost of capital to companies, enhances capital formation, and encourages productivity growth. Implicitly, banks influence the operations of companies and the prosperity of nations.

Another characteristic of the banking sector is that it is affected by the imbalanced distribution of information. Information asymmetries are present in all business sectors, as Levine [68] highlights, but these informational asymmetries are larger with banks. In the banking sector, the quality of loans cannot be readily observed and can be hidden for a long period of time. Also, the risk composition of their assets can be changed more quickly in banks than in most nonfinancial industries. As a solution for hiding problems, banks can expand loans to clients that cannot service previous debt obligations. The complexity of the banking activities, discussed in previous paragraphs, deteriorates the information asymmetries, as per De Andres and Vallelado [69].

Moreover, the lack of balance of a single bank can easily extend to other banks and influence the whole banking sector, with negative consequences for the entire economy and ultimately for the economic and political stability of a country. Another feature of the banking sector nowadays, which needs to be considered, is globalization. It is a phenomenon that extends in the financial markets, where, there are internationally connected markets and the costs of global transactions decreased significantly and due to the spread of modern technologies information across different countries worldwide simultaneously. The banking business is nowadays increasingly global, proof being the operations on the traditionally international financial market, the operations with corporate customers, as well as the operations with private customers that have recently become more and more regular.

All the above-mentioned characteristics of the banking sector, explicitly emphasize its central role to the economy. In short these characteristics, including the liquidity production function, the crucial role in the payments system, the lack of transparency and complexity, the information asymmetries, the globalization phenomenon, the trend to instability and the systemic risk validate the existence and necessity of prudential regulations of the banking sector. Indeed, the economics and functions of banks vary from those of industrial companies, because of these differences; banks are subject to rigorous prudential regulations of their capital and risk. Moreover, these differences are reflected

in corporate governance practices used by the banking sector and in theoretical frameworks on the CG of banks". In general in the financial market, banks play the role as financial intermediaries between lenders and depositors (Mishkin and Eakins [70]). This responsibility of banks towards protecting depositors' funds has made corporate governance important for financial institutions to maintain public trust towards the banking system and to maintain the stakeholders‟ confidence including the shareholders and investors (Basel Committee on Banking Supervision [71]).

Following are some economic and financial indicators that justify the great importance of the UAE banking sector for the country's economy in 2013(IMF World Outlook Database [72]; NBAD Annual Report [73]; UAE Central Bank Annual Report [74]):

- UAE is the seven largest oil reserves in the world;
- The UAE economy is the second largest economy in the Gulf Cooperative Council (GCC) and in the Arab world and the 29th largest GDP in the world;
- The UAE's real GDP growth was 4.8%;
- The non-oil sector constituted nearly 60% of GDP, with strength coming from a recovery in real estate, trade and tourism;
- The UAE banking sector contribution to GDP was (7.4%);
- The UAE banking sector is the largest one in the GCC (UAE 34%- Saudi Arabia 32%- Qatar 16%- Kuwait 11%- Oman 4%-Bahrain 3%)
- The UAE banking sector comprises of 51 banks (23 local, 28 foreign)
- The UAE banking sector loans were up 7.1%; loans-to deposits ratio was at 92%, and net assets grew over 13%;
- The UAE banking sector capital adequacy ratio remained high at 19% reflecting the core strength of the sector;
- In Jan'14, the UAE banking sector net loans and customer deposits grew 0.8% and 1.0% respectively from December 13 levels.

The literature review suggests that corporate governance mechanisms of banks require an empirical investigation to recognize and distinguish the different corporate governance frameworks from those of other companies (Al Saeed [41]).The foregoing literature review on CG in banks has outlined that CG as an important agenda because it has an impact on the growth, employment and economic development of a country. This research focuses on corporate governance mechanisms adopted by UAE national commercial banks because their conduct and behavior can have the positive/negative impacts on the country economy.

5.2 Corporate Governance Guidelines for UAE Banks' Directors

There is a growing convergence of corporate governance principles and standards across the world and the OECD has developed global corporate governance principles that guide policymakers across national boundaries. As per the OECD, the corporate governance framework should encourage transparent and efficient markets, be consistent with the laws and regulations and clearly divide the responsibilities among different supervisory, regulatory and enforcement authorities. The OECD principles of corporate governance are grouped into the following categories (OECD [4]; 10 Al Saeed [41]):

1. Shareholders' rights and duties. Any effective corporate governance framework should ensure that owners' rights are protected and exercised and their duties are respected and carried out.
2. The fair treatment of shareholders: An effective corporate governance framework ensures that all shareholders, including minority and foreigners should be treated fairly. All shareholders including controlling and non-controlling ones should have the opportunity to obtain effective remedy for violation of their rights.
3. The Role of shareholders: an effective corporate governance framework should ensure that timely and accurate disclosure is made of all required and relevant information regarding the company, including the financial situation, performance, growth, ownership structure, and governance of the company. Also, other behavioral patterns, such as transparency and accountability and efficiency should be adhered to by companies.
4. The board responsibilities: An effective corporate governance framework should ensure responsibility of the board on the strategic direction of the company, the effective monitoring of management and the accountability to the company and the shareholders.

Based on the OECD global corporate governance principles, the Central Bank of the UAE in June 2006, published a framework of guidelines ensure the basis for an effective corporate governance for UAE bank boards of directors. This framework presents an informative and practical guide to corporate governance practices and to directors' functions in UAE banks. The guidance focuses on the principles of good corporate governance rather than set out detailed rules. The guidance also assists bank directors to become more effective contributors to their boards and to the success of banks (UAE Central Bank, Corporate Governance Guidelines [75]).
The guidance considers existing laws and regulations and therefore directors should be aware of the relevant rules and regulations. The guidance also presents a number of model charters and other documents which are driven from banks outside the UAE and should be regarded only as examples. They may help UAE bank boards to develop their own documents to align with their bank’s individual circumstances. The vast majority of UAE banks' board members are non-executive directors elected by shareholders who may include governments and/or families who control the bank. However, the board of directors is responsible to all the bank’s shareholders, who own the company. Board members should act as stewards of the business on behalf of all shareholders. As required by Central Bank Circular 23/00, directors should contribute to board discussions and decisions independently. Appointments of directors will need to be notified to the Central Bank who will wish to be satisfied that they are the most relevant personnel. The regulator will need to be satisfied as to the person’s: honesty, integrity and reputation, competence and capability, and financial soundness. All board members should be elected by shareholders for three-year terms and then be required to seek re-election.
The board’s role is to encourage the entrepreneurial leadership of the bank within a framework of discreet and effective controls which lead to assessing and managing the bank risk. The board is responsible for strategic direction, management supervision and effective controls with the ultimate objective of encouraging the success and long-term value of the bank. The board must ensure that management pursues the balances between long-term growth and the delivery of short-term objectives. The board must ensure that management adopts a system of internal control that provides assurance of effective and efficient operations, internal financial controls and compliance with laws and regulations. The board is the decision-making body for all issues that are significant to the bank as a

whole because of their strategic, financial or reputational implications or consequences. The board has the authority to decide on all issues except those that are kept by law or the Articles of Association to the authority of the shareholders in general meeting.

5.3 The Role and Responsibilities of the Board

The Board is responsible for directing banks and their subsidiaries towards the achievement of banks' vision and strategic goals. The board ensures banks' strategic leadership, financial soundness, governance, management supervision and control. The board delegates certain authorities and powers in specific areas to management, several committees, such as executive or management committee, remuneration committee, nomination committee, audit and compliance committee, credit committee, and risk management committee. Also, some powers can be delegated to individuals, such as the CEO. The scope and extent of authorities and powers that are delegated by the board should be set out clearly in an institutional manual and should be freely available to all employees. If the board believes management is failing to carry out its delegated powers satisfactorily then it should take back those powers to the board.

6 Corporate Governance Mechanisms in UAE National Commercial Banks

Descriptive statistics on corporate governance mechanisms adopted by each bank in the study are presented in the following tables. For reasons of clarity, the following tables firstly present the governance mechanisms and other relevant data of every bank in the study.

Table 4: Summary of Governance Mechanisms used by UAE National (P.S.C) Banks

Governance Mechanisms	B1	B2	B3	B4	B5	B6	B7	B8	B9	B10	B11	B12
The Board of Directors	X	X	X	X	X	X	X	X	X	X	X	X
Executive Committee			X	X	X		X		X			
Audit and Compliance Committee	X	X	X	X	X	X	X	X	X	X	X	X
Nomination and Remuneration Committee	X	X	X	X	X	X	X	X	X	X	X	X
Credit Committee	X	X	X	X	X	X	X	X	X	X	X	X
Risk Management Committee	X	X	X	X	X	X	X	X	X	X	X	
The auditor	X	X	X	X	X	X	X	X	X	X	X	X
Asset Liability Committee			X				X			X		
Corporate Governance Committee	X										X	
Strategy and Transformation Committee	X											
The Financial Market												
The Market for Goods and Services												
The Labor Market												

Source: Adopted from UAE National Commercial Banks' Annual Reports, 2013/2014

To analyze the results of the study, it is necessary to translate the information contained in tables 4 and 5 in histograms which facilitates the reading and understanding of the results and makes it easier to identify characteristics of the corporate governance system of banks.

Table 5: Board Size, Independence and Ownership Structure of UAE National (P.S.C) Banks

Measures/Stand.	B1	B2	B3	B4	B5	B6	B7	B8	B9	B10	B11	B12
The Size of Board of Directors	11	7	8	11	9	11	6	7	7	8	11	7
Dual Direction	NO	Y	NO	NO	NO	NO	Y	Y	NO	NO	Y	NO
The number of Non-Executive Directors on the Board of Directors	11	6	8	10	9	11	5	6	7	8	10	7
The number of Executive Directors on the Board of Directors	Zero	1	Zero	1	Zero	Zero	1	1	Zero	Zero	1	Zero
Directors on Appointment*	GA	GA	GA	GA	GA	GA	GA	GA	GA	GA	GA	GA
Directors' Compensation *	GA	GA	GA	GA	GA	GA	GA	GA	GA	GA	GA	GA
Board Performance Evaluation	Board	Board	Board	Board	Board	Board	Board	Board	Board	Board	Board	Board
A total number of meetings during 2013	8		6	6	8	8	4	5	8	4	8	4
Ownership Structure (Government-Others**)	-GI 78 - Oth..22	-GI 80 -Oth. 20	-GI 52.7 -Oth. 47.3	-PI 76.5 -Oth. 23.5	-GI 55.6 -Oth. 44.4	-GI 20 -Oth. 80	-GI 86.4 -Oth. 13.6	-PI 87 -Oth. 13	-GI 55 - Oth. 45	-GI 60 -Oth. 40	-GI 59.4 - Oth. 40.6	100% Public - owned -

* GA (General Assembly)

** Others (Private Companies and/r Individuals)

Source: Adopted from UAE National Commercial Banks' Annual Reports, 2013/2014

Corporate governance mechanisms used by UAE banks need to be supplemented by other data that have a direct influence on the banks' corporate governance, including the ownership structure, the size of the board of directors, the percentage of external or non-executive directors on the board vis-à-vis internal or executive directors, and the case of dual direction, where the president of the board is himself the chief executive officer (CEO). These data provide a clear picture of the independence of the board and therefore the effectiveness of its governance.

6.1 Ownership Concentration (Characteristics)

According to the agency theory two components of the ownership structure, including ownership concentration and the nature of the shareholders may be the cause of the performance of a company. The ownership structure is an effective means of control of management executives, as it brings together, when certain conditions are present (capital concentration and nature of the shareholders), the basis for efficient monitoring system, namely, an incentive controllers to perform their functions, as well as cost control (20). As shown in figure 1, around 60% of the ownership of UAE national commercial banks is concentrated in government hands. Moreover, around 73% of ownership is held by large institutions, including government bodies and private companies. These highly concentrated ownership models in UAE banks, like those found in Germany characterize weak minority shareholder protections and a higher concentration of voluntary disclosure requirements. Unlike, countries with high levels of fragmented ownership such as the UK and the USA, which tend to have stronger protections for minority shareholders and mandatory information disclosure requirements. (Williams and Mas [37]).

Figure 3a: UAE National Commercial Banks' Ownership Structure by Size

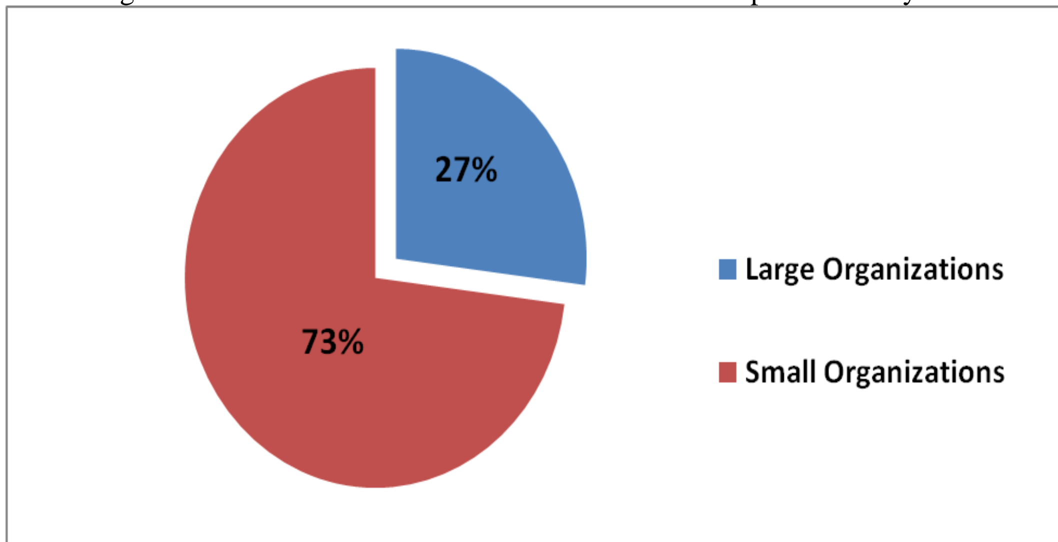
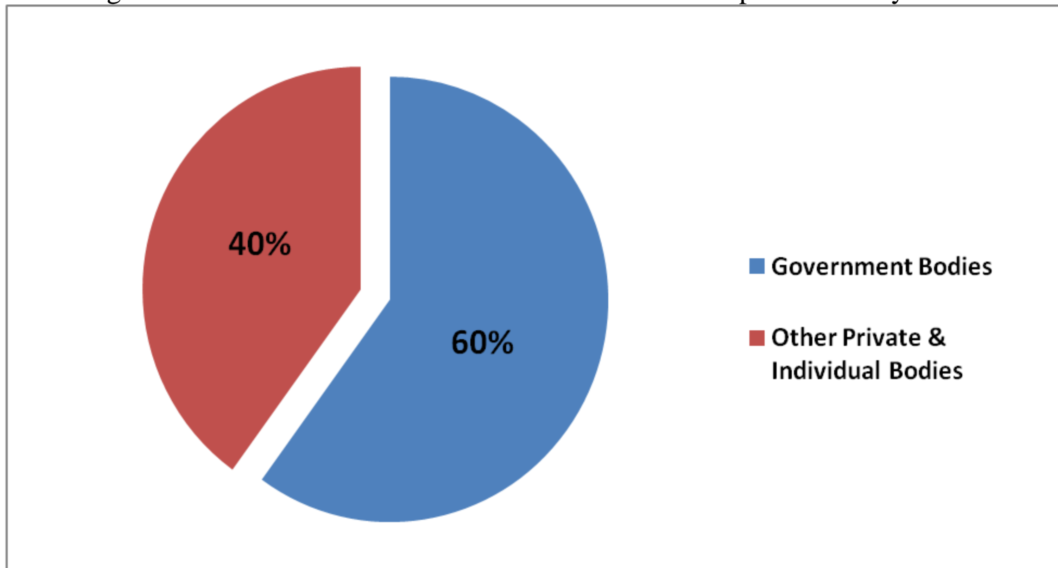


Figure 3b: UAE National Commercial Banks' Ownership Structure by Sector



Institutional investors provide an additional method of monitoring the actions of management. For example, (Mcknight and Weir [76]) show that institutional investors vote more actively on anti-takeover modifications than do other shareholders, and that they are more likely to oppose proposals that appear to be harmful to shareholders. Institutional investors have greater expertise and resources and can monitor management at lower costs than the average, less well informed, private shareholder. Large shareholders can be particularly important in corporate governance since not all shareholders are able and willing to control management, but presume that owners with large stakes will supervise the management. More concentrated shareholdings by insiders provide a superior incentive and ability to monitor owing to a claim on all residual profit and control over the board of directors (Mcknight Weir [76]; Bolton & Scharfstein [77]; Gedajlovic and Shapiro [78]). Hence, according to Gedajlovic and Shapiro [78], concentrated ownership is a powerful constraint on managerial discretion.

Given that the monitoring benefits for shareholders are based on their equity stakes (see, for example, (Hart [11]), a small or average shareholder has little or no motives to exercise monitoring behavior. In contrast, controlling shareholders have more incentives to oversee management and can do so more effectively monitoring behavior (Shleifer and Vishny [3];Shleifer and Vishny [9]). In general, the bigger the number and amount of stocks that shareholders hold, the stronger their motives to monitor and protect their investment.

The involvement of institutional investors has emerged as a vital force in corporate monitoring and as a mechanism to protect the interest of minority shareholders. In USA, the large institutions play a central role in pursuing greater director independence and in choosing the lead directors for chairman post in companies in which they invest their fund (Hashim and Devi [79]). Gillan [29]) indicated institutions that hold large equity positions in a company are motivated to actively participate in the company’s strategic direction. Institutional shareholdings will facilitate take over’s due to the minimal transaction costs and the extent of their holdings will minimize free rider issues that could force minority

shareholders to accept the decisions. These investors are well-informed and regularly practice their voting rights to monitor the managers.
To conclude, the ownership structure of UAE national commercial banks which are characterized by the ownership concentration and the domination of institutional ownership can act as an additional corporate governance mechanism to control and monitor management activities and actions and to ensure shareholders; interests.

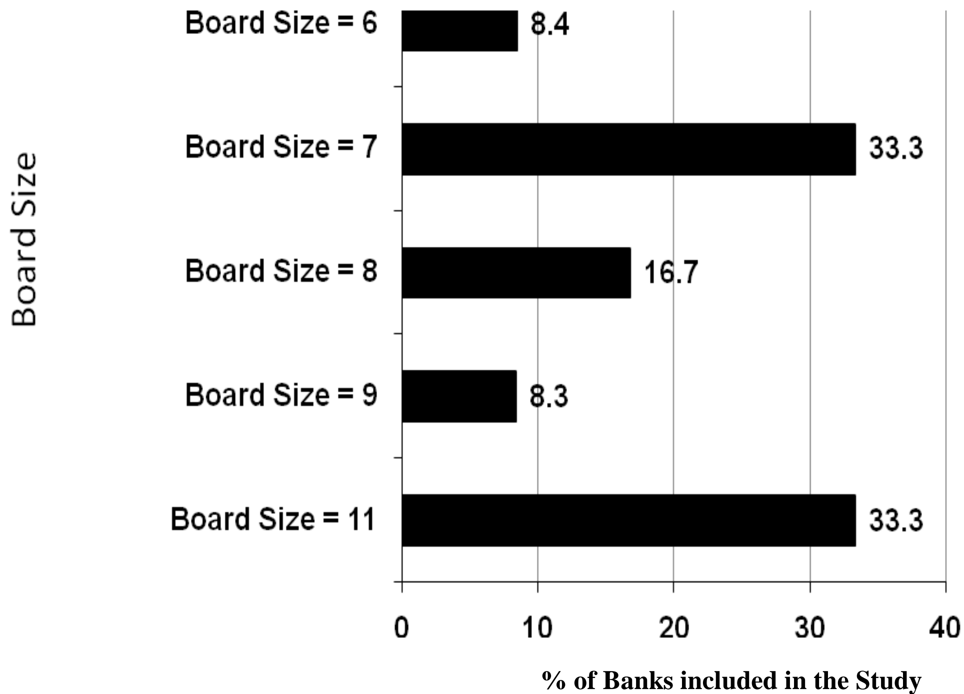
6.2 Board of Directors' Characteristics in UAE banks

The board of directors is an important component of the governance system of banks. But the key element for banks, as well as for business sectors is not the existence of the board, but rather its ability to achieve its roles. This ability of the board depends (as indicated above) on several factors, including its size, composition, presidency, policy of nomination of directors, the evaluation of their performance and executive compensation policy. Since, compensation packages provided to senior management in UAE national commercial banks are not revealed in banks annual reports and other published documentations. Hence, management compensation's policies are not taken in account as one of the corporate governance mechanisms used by these banks. The analysis of the independence and effectiveness of boards of directors will be based on their size, composition and presidency. The composition of boards of directors, precisely the proportion of independent or non-executive directors (NEDs) is a measure of board effectiveness and independence. Boards which have a majority of independent directors or NEDs are considered to be more independent and credible than others. On the other hand, regarding the duality of direction; the board is considered to be independent when its president is not the CEO of the company. The following sections present a comprehensive analysis of the board size, composition and the dual direction of UAE national commercial banks.

6.2.1 Board Size

Regarding the size of the boards of directors in UAE banks, the article 95 of the commercial code of companies No.8 of 1984 provides that the company should be administered by a board of directors composed of at least three members and maximum fifteen members. As shown in figure 4, results revealed that 33.3% of banks opted for the highest number of board members namely 11 members, 8.4% of the banks have chosen a board of 9 members, 16.7% opted for a board of 8 members, 33.4% opted for a council of 7 members and 8.3% of banks have chosen a board of 6 members. In other words, the average number of members per board is almost 9 (8.58), which are considered to be average board size as per the previous studies.

Figure 4: Board Size in UAE National Commercial Banks



Board size is believed to be the basic aspect of the effective decision making. Vafeas [80]) suggested that the board size and its performance had a non-linear relationship. Both too small and too large of the board size is likely to make it ineffective. (Jensen [81]) claimed that when the board is more than seven or eight members, it is less effective because of the coordination and process problem, which in contributes to weak monitoring and recommended that the ideal board size should not exceed eight or nine members. Although Bozec and Dia [34]) have shown that for state-owned enterprises (SOEs) that have been exposed to market discipline, board size has a positive relation to technical efficiency since bigger boards may be constructive for some companies as they provide diversity that would help companies to secure critical resources and reduce environmental uncertainties (Goodstein et al. [82]).Other previous studies have shown that small boards are more effective because the directors can communicate better among them, as well as easy to manage. These factors promote a more resourceful conversation. For example, studies of the board size and corporate performance have indicated that small boards are linked with higher market values.

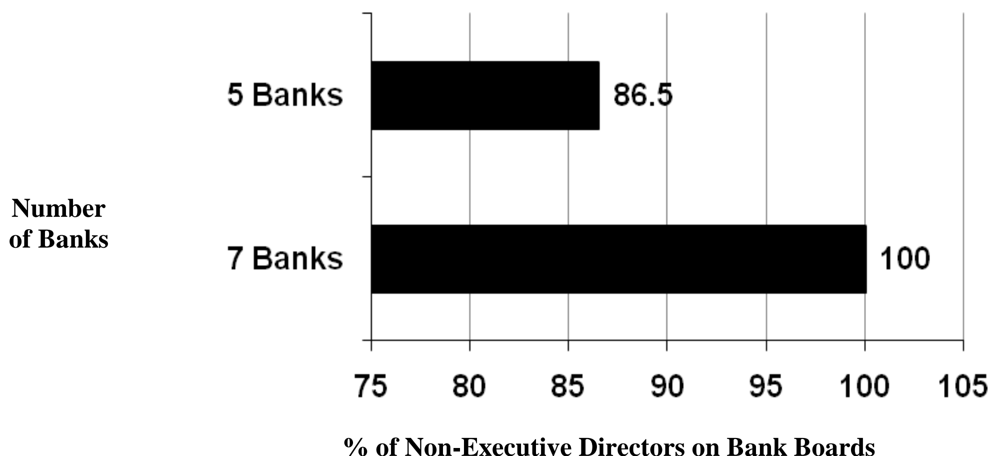
Moreover, other papers concerning the private company have found a negative relationship between board size and company value as a consequence of the increase in agency problems caused by the presence of a greater number of directors, which leads to less effectiveness in management control (Andres et al. [83]). Specifically, these authors, in accordance with Jensen [81] agency theory perspective, ensure that a larger board size increases problems in communication and coordination and thus decreases the ability of the board to control management. It then becomes more symbolic rather than being a part of the management process.

The average number of members per board in UAE national commercial banks is consistent with the effective average board size as per the previous studies (Jensen [81]; Bozec and Dia [34]). The average boards size in the studied banks make these boards more effective with regard to coordinating functions and monitoring management activities.

6.2.2 Board Independence

There are two components that characterize the independence of a board, the proportion of non-executive directors (NEDs) versus executive directors (EDs) who are full-time employees of the company on the board and the chief executive officer (CEO) duality (Weir & Laing 2001(12)). Boards with a significant proportion of NEDs can limit the exercise of managerial discretion by exploiting their monitoring ability and protecting their reputations as effective and independent decision makers. Meanwhile, NEDs are needed to provide independent assessment such as pay awards, executive director appointments and dismissals when dealing with the executive directors. An independent board of directors contributes with the directors' independent judgment, as a crucial mechanism for an effective control of management actions; these directors could be expected to be advocates of the shareholders' objectives (Fama and Jensen [10]). Boards dominated by NEDs may help to ease the agency problem by monitoring and controlling the opportunistic behavior of management since they (1) ensure that managers are not the sole evaluators of their own performance and (2) influence the quality of directors' deliberations and decisions due to their independence, expertise, prestige and contacts and the fact that they are concerned with maintaining their reputation in the external labor market (Jensen and Meckling [2]; Pearce and Zahra [84]; Fama and Jensen [10]). Figure 4 presents the results of our study about the independence of the boards in the following graph:

Figure 4a: Board Independence (Executives – Non-Executives Directors)



The composition of boards of directors, precisely the proportion of NEDs is a measure of board independence and effectiveness. Boards which have a majority of independent directors or NEDs are considered to be more credible than others. This is the case in UAE national commercial banks. As shown in figure 4a, the vast majority of banks' boards of

directors are NEDs (100% of board members are NEDs in seven banks and 86.5% of board members are NEDs in the other five banks). Accordingly, only in five out of the twelve banks, there is one member on the board is EDs. In average, the percentage of NEDs on banks' boards of directors is 95%, while the percentage of EDs on those banks' boards is 5%.

Board directors are elected by the shareholders during the Annual General Meeting. The NEDs are obliged to immediately inform the board of any circumstance which may impact upon their independent status. The nominations committee is charged with nominating suitable candidates for the shareholders to consider for election. All directors serve a maximum term of three years, and there is no barriers against retiring directors, if considered appropriate, being re-nominated for election at Annual General Meeting. As the Articles of Association fixes the number of board directors, the board may also appoint new directors to fill vacancies arising during the year, and any director so appointed must seek re-election at the next Annual General Meeting (Articles 95 to 118 of the UAE Commercial Code of the Companies [85]).

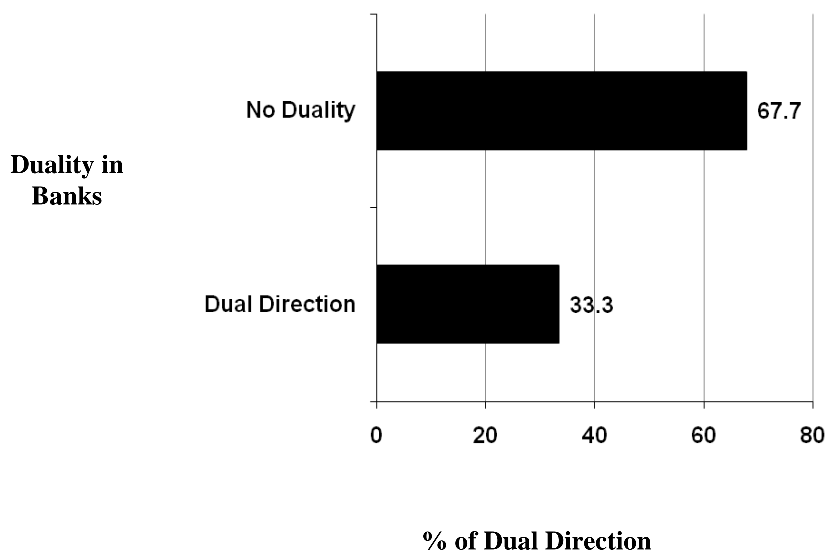
Several studies support the view that NEDs have a positive effect and find that boards dominated by NEDs are more likely to act in the best interests of shareholders. Fama and Jensen [10] showed that reputation concerns, fear of lawsuits and the market for their services motivate NEDs to be effective monitors of the board's decisions. (Brickley et al. [86]) find evidence that boards take account of ability, based on previous performance, when appointing outside directors. NEDs are associated with the responsibility to monitor managers and thus reducing the agency costs that occur from the separation between ownership and control in day-to-day company management. (Fama and Jensen [10]) provide evidence suggesting that the proportion of independent NEDs on board is an effective monitor. Besides, the agency theory also suggests a greater proportion of independent NEDs in order to monitor any self-interested actions by executive directors and to minimize the agency cost. Therefore, higher proportion of the independent NEDs on boards is expected to lead to a more effective monitoring function which then results in more reliable financial statements. This is because of the incentive for independent board members to develop reputation as experts in decision making and to provide an unbiased assessment of the management actions (Fama and Jensen [10]).

However, few studies find exactly the opposite results. They suggest that NEDs are usually characterized by lack of information about the nature of business, do not bring the required skills to the job and, hence, prefer to play a less confrontational role rather than a more critical monitoring one (Franks et al. [87]). As far as the separation between the role of CEO and COB is concerned, it is believed that separated roles can lead to better board performance and, hence, less agency conflicts. NEDs may exert better control, reduce agency costs, bring outside resources and increase financial transparency; the benefits are not necessarily realizable. In this sense, the NEDs may not be able to exert influence well, partly because they lack the superior information hold by EDs and partly because of time constraints as a result of multi-company independent outside director appointments. In addition, NEDs may lack professional knowledge about each business or the ability to monitor actions of the management. The EDs are better placed for evaluating company management. Moreover, the EDs benefit the company because of the extent of their firm specific information Raheja [88]).

Regarding the duality of direction; duality refers to the CEO who is also the chairman of the board. In other words, a person has two powerful positions, which would result in probability that person hides unfavorable information to outsiders. It is because a

chairman has a responsibility to monitor the directors on the board as well as the CEO. Besides, it also enables the CEO to engage in opportunistic behavior since he/she has dominance over the board. When CEO duality exists, the CEO's decisions and actions may be directed to achieve his/or her own interests at the expense of the interests of the shareholders. In the UAE, there are no mandatory rules for the separation of roles between both chairman and CEO. The adoption is recommended in the UAE Code to separate the roles of chairman and CEO. The board is considered independent when its president is not the CEO of the company. As shown in figure 4b, only around 33% of UAE national commercial banks have dual roles as chairman or vice chairman of the board of directors and CEO. So, there is a desire to make the control in banks more effective and rigorous which could be affected by the duality of direction.

Figure 4b Board Independence (Duality Direction)



CEO duality decreases the independence of the board of directors and leads to lower board performance as it is difficult to remove an inefficient CEO who creates an agency cost due to his individualistic behavior at the expense of other shareholders. Similar arguments were provided by (Fama and Jensen [10]).The CEO is responsible for managing the company's operations, providing leadership, financial performance, preparing strategies, plans, objectives, and communicating to the investors. While, the chairman manages and reviews the board, scrutinizes activities and strengthens the image and goodwill of the company. Separation of the role of the CEO and Chairman is vital in easing problems relating to corporate governance practices in companies (Brickley et al. [86]). Having multiple roles will lead to difficulty in the implementation of their respective roles and lead to and mismanagement. (Jensen [81]) indicated that having separation between the CEO and chairman of the board creates independence and increases the effectiveness of the board, which reduces agency problems between shareholders and managers. Since CEO duality means that the same person is the one responsible for making and implementing strategic decisions and also for evaluating the

effectiveness of those decisions, there is an increased possibility that the CEO will act in his/her own interests and reduce company performance.
The Stewardship theory advocators, such as (Brickley et al. [86]) support the CEO duality as they argue that it strengthens the company and therefore lead to better firm performance. A discord between the CEO and chairman makes it difficult for the CEO to make decisions favorable for the shareholders. The executive manager, under this theory, far from being an opportunistic behavior, essentially wants to do a good job, to be a good steward of the corporate assets. In this context, duality can involve certain advantages associated with the unification of leadership and a great knowledge of the company's operating environment that should impact positively on company performance. Specifically, duality helps (1) enhance decision making by permitting a sharper focus on company objectives and promoting more rapid implementation of operational decisions and (2) shape the destiny of the company with minimal board interference, which could also lead to improved performance resulting from clear, unfettered leadership of the board (Stewart 1991(1).
Based on the foregoing argument, this study can conclude from all these characteristics of the boards of directors that UAE national commercial banks are increasingly opting for a more independent board capable of protecting the interests of shareholders and discipline of managers.
The results of the study confirm the specificity and the particularity of the banking sector. Indeed, it is a highly regulated industry regarding the mechanisms of corporate governance.

6.2.3 Board Performance Evaluation

It is best practice that the performance of the board, its committees and its members is evaluated at least once a year. The purpose of these evaluations is to assist the board achieve its objectives more effectively. Boards should consider the issues that are appropriate to their own and the bank's circumstances. This guideline does not deal with individual director appraisal but banks are encouraged to move in that direction to comply with best international practice.
In theory, as per the UAE Central Bank guidelines, board evaluation tends to break down into people and process factors. Following are some specific performance measures or standards upon which the UAE banks' board performance is evaluated (UAE Central Bank, Corporate Governance Guidelines [75]):
-Setting and implementing clear performance objectives;
-The board's contribution to the development of strategy;
-The board's contribution to ensuring effective risk management;
-To what degree the relationships between the board directors and the CEO/General Manager are working effectively;
-The board response to any problems or crises;
-Are there effective relationships between the board and its committees?
-Is the board remained up to date with regulatory and market developments;
-The board ability to obtain appropriate and timely information of the right length and quality;
-The right time duration of board meetings to enable proper consideration of issues;
-To what degree board procedures appropriate for effective performance.

In reality, in most of UAE national commercial banks, performance evaluation of the board and its committees takes place on an annual basis. Evaluation is designed to include the board as a whole and to evaluate each committee, both in terms of their internal performance by members collectively and how the committee performs from the perspective of the board. For instance, in 2013, the NBAD' board directors were requested to complete a comprehensive questionnaire covering a range of performance measures and indicators on issues such as: board roles and responsibilities; performance with respect to corporate objectives and risks; board and committee structure and skills; meetings; decision-making; committee scope and performance; and the interaction between the board and senior management. Interviews with the directors were also held in order to expand upon matters of interest arising from the questionnaires and enable additional feedback. Furthermore, the board's commitment to benchmark and enhance its processes, the 2013 evaluation was designed and conducted by an external advisor. The results from the evaluation is considered by the nomination committee, and presented to the board with recommendations for future corrections developments and potential topics and options for expanded evaluation in following years (NBAD Annual Report [73]).

6.3 Board Committee Structure

Regarding the importance of board activity to board effectiveness, a significant research effort has focused on the impact of committees (Vafeas [80]), finding that there is a link between the presence of board committees and board effectiveness. The establishment of board committees is a means to channel the many functions of the board into specialized groups of directors that will focus on specific subject matters concerning the operations of the corporation. Thus, a greater number of committees would involve greater involvement of the board members, which would lead to greater effectiveness of the board (Sanchez [33]). In general, the board of directors has overall responsibility for directing banks' affairs, to create and preserve value through the banks' operations, and to protect shareholders' and other stakeholders' interests. In all banks under investigation, the roles and responsibilities of the board has documented in a board charter and associated policies. Banks' boards have established a number of committees, each of which remain an integral part of the board and whose members are directors of the board. The key role of these committees is to consider topics in more detail, to manage conflicts of interest, to satisfy regulatory rules, and other relevant activities as necessary to ensure the proper corporate governance of banks.

In this sense, this study reveals that all UAE national commercial banks have a board of directors, a permanent audit committee, a credit committee, and an executive committee. It is not by chance or necessarily by conviction. Indeed, these mechanisms are obligatory in the banks. Among these mechanisms, there are some committees that are not specific to banks, such as the board of directors, the auditor, nomination committee, remuneration committee and risk management committee. Other committees exist in few banks, such as strategy and transformation committee, corporate values and code of ethics, and corporate strategy and decision making process.

In UAE banks, the board of directors is governed by articles 95 to 118 of the UAE commercial code of the companies, No. 8 of 1984 and its impediments published in law no 26 of 1988. These items determine the composition, the appointment of members of the board, their rules and activities. Similarly, the commercial code of companies determines the role of the auditor. In addition to, the different accounting standards and

circulars of the central bank relative to the establishment of credit obliged, which requested from every credit institution to create a standing committee of internal audit. Moreover, these circulars forced many banks to create a permanent audit committee. In fact, effective supervision of banking institutions is essential to give their central role in payment transactions, credit and bankruptcy propagation from one bank to all other banks, even performing ones. Figure 5 shows the different obligatory and optional governance mechanisms used by banks.

Even if the board constitutes the basis of the system of governance of banks, this does not deny the role of other mechanisms. Three mechanisms are of great importance; the permanent audit committee, the auditor and the credit committee. The permanent committee of internal audit, whose role was defined by UAE Central Bank Circular of June 2006 for credit institutions, as the Board Audit and Compliance Committee, in consultation with the Chief Financial Officer, the Group Auditor and the External Auditor, is to receive and consider reports and recommendations from management and to make recommendations to the board in respect of the financial reporting, systems for internal control and both internal and external audit processes of the bank. There is a growing awareness in some banks that internal control is one of the pillars of competitiveness. The main duty of audit committee is to meet the external auditors regularly to review financial statements, audit processes and internal accounting system and control. Therefore, the audit committee ensures that there is continuous communication between the board and external auditors. In the UAE, Abu Dhabi and Dubai stock exchange listing requirements mandate every listed company to establish an audit committee. The independence of audit committee is based on proportion of independent NEDs in the committee. This independent audit committee will increase the effectiveness and efficiency of the board in monitoring the financial reporting process of a company. According to the agency theory, the independent members in audit committee can help the principals to monitor the agents' activities and reduce benefits from denying information. This the case in UAE national commercial banks, whose audit committees' composition is dominated by NEDs, driven from the fact that the proportion of NEDs on banks' boards is 95%, as explained in board independence section.

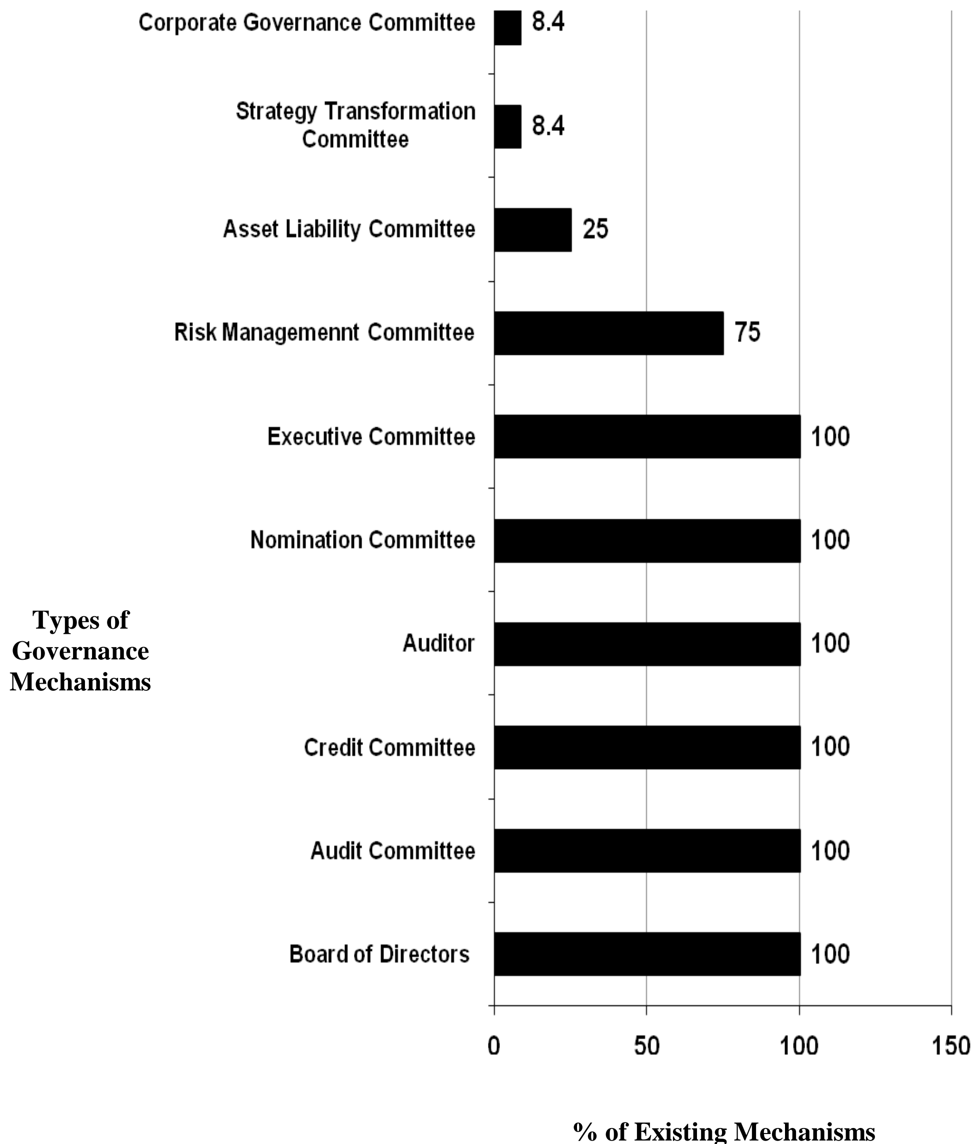
The Audit Committee helps the board of directors in ensuring and maintaining oversight of the bank's financial reporting system, internal control and risk management framework, and audit functions, legal and regulatory requirements.

The credit committee (namely credit and investment committee in some banks) is one of the committees that is established by the board of directors and whose major responsibility has to do with: reviewing the quality of the bank's credit and investment portfolio; supervising the effectiveness and administration of credit-related policies; and approving loans and investment above management limits.

Given that most if not all of the banks under investigation have remuneration and nomination committees (namely human resources committee or compensation, nomination and remuneration committee in some banks), which focus on ensuring that director appointments and compensations, including EDs and NEDs, are made on merit rather than by patronage. An effective nomination committee should therefore ensure the appointment of NEDs whose interests are aligned with those of the shareholders and so help reduce agency costs. While, an effective remuneration committee should ensure that strategic human resources are recruited, remuneration and performance pay schemes, policies and framework are aligned with banks strategies and policies. Furthermore, the remuneration committee must ensure that appointment, promotion, remuneration,

retirement and dismissal of senior management are made on merit and performance evaluation, and high level succession planning is made properly.

Figure 5: Corporate Governance Mechanisms Adopted by UAE National commercial Banks



Most of banks (75%) have a risk management committee, which plays a key role in reviewing and approving the bank's key risk policies on the establishment of risk limits relating to operational and information security risks and receiving reports on the compliance with significant limits. It is responsible for reviewing the bank's regulatory risk capital (credit, market, liquidity and operational risks), including significant inputs

and assumptions. Additionally, it oversees and evaluates issues relating to anti-money laundering, internal controls and procedures, and other legal issues. It is an active committee with delegated decision-making authority on material credit approvals and the strategic risk issues. More specifically, the committee oversight and review of:

• Banks' risk methodology, KPIs and tolerances, including stress testing.
• Trading, investment, liquidity, funding and interest rate risk, including transfer pricing.
• Risks of strategic acquisitions or disposals.
• Adequacy and allocation of capital.
• Management proposals, material risk transactions and Central Bank approval if required.
• Alignment of remuneration to risk.
• Risk disclosures and reports.
• Compliance with regulatory requirements.
• Overall risk management framework, including adequacy of company procedures, material findings of regulators, independence and resourcing of the risk function, and assurance from internal audit on risk controls.

Some banks (25%) have asset liability committees. This committee is responsible for evaluating and reviewing all inter-bank counterparties and their relevant limits and assesses the bank's appetite/requirement for investment instruments and recommends purchasing, repurchasing, holding, or selling investment instruments (RAK Bank Annual Report [89]; FGB, Annual Report [90]).

ADCB and NBAD (around 17% of banks) have corporate governance committees. The board governance committee is responsible for supervising the preparations and amendments of the Code and to ensure that the bank maintains high standards of corporate governance, which include over sighting and reviewing all of the following (NBAD, Annual Report [73]; ADCB, Annual Report [91]):

-The bank's governance charters, policies, practices and structure;
-The size and composition of the board and its committees relative to the responsibilities of each;
-Director independence;
-Allocation of responsibilities to the committees, directors and company secretary;
-Board membership and management of subsidiaries;
-The measures to implement accepted culture and ethics within the bank;
-Corporate governance developments internationally and domestically with recommendations for the bank's development plan; and
-The bank's corporate sustainability incentives

Specific banks, such as NBAD has developed strategy and transformation committee, which is responsible for: Assisting the bank board in fulfilling its strategic plan; assisting the board performance in terms of executing the bank's strategy and related transformation: implementation plan, expansion, acquisition strategy and potential acquisitions; reviewing and evaluating major unbudgeted expenditure, external developments and factors related to senior staff and (NBAD, Annual Report, [73]).

The foregoing analysis of the board activities, including the existence of board committees and their roles, authorities and responsibilities indicated that all UAE national commercial banks under investigation have committees imposed by the laws and regulations, such as the audit committee, the credit committee and the executive committee. However, many banks have other committees created voluntarily to enhance

corporate governance systems in these banks such as risk management committee, and nomination and remuneration committees. In addition this, the board committees are increasingly more independent due to the composition of these committees which are dominated by the NEDs.

6.5 Interaction among Different Corporate Governance Mechanisms

The comprehensive and deepening revision of UAE national commercial banks' annual reports showed that many banks have no information about external governance mechanisms. However, it does not mean the nonexistence of any role of these mechanisms in the corporate governance of the banks, this finding is only indicative of a basic reality in the banking sector, namely the importance of internal governance mechanisms relative to the external governance norms (Damak [7]). The discipline exercised by external mechanisms of governance is ineffective due to the high opacity. It affects relationships between managers and board of directors in the bank. It also affects the relationship between these internal and shareholders. Similarly, it can affect the relationship between stakeholders and other partners of the bank, including creditors, depositors and regulators. Other features of the banking sector may explain the prevalence of internal mechanisms for reporting to external mechanisms, for example competition in the services market is low at banks, given that managers establish barriers to access to information needed by developing networks of relationships with their customers (Levine [68]).

Competition among banks is limited by the shareholding of the State that holds significant shares in the capital of these banks and important shareholding of families which also prevents the entry of new competitors. Thus, foreign investors would be less willing to compete with local banks. The efficiency of the stock market is also destabilized by the presence of the regulations and the high gratitude of banks (Levine [68]).

7 Conclusions and Recommendations

CG is neither a trend nor the result of chance; it is associated with the evolution of modern business and the separation of ownership and control. CG does not only concern the shareholders and managers. But, it must be extended to all the relationships that managers have with stakeholders who are, for example, employees, suppliers, customers, creditors, depositors and shareholders. It was necessary to begin start the paper by presenting the theoretical foundations of the CG; since there is an immense need to understand the ability to provide the remedy. The need drives from the conflicts between managers and stakeholders, especially shareholders. These conflicts lead to negative consequences for the company. The appropriate remedy could be a system of corporate governance comprising internal corporate governance mechanisms such as the board of directors, the audit committee, the auditor, the credit committee the executive committee and external mechanisms that are mainly the financial market, the market of goods and services and the labor market of managers. However, the existence of one or more of these governance mechanisms is not in itself a guarantee of efficiency. Accordingly, the effectiveness of the board depends on its size, its composition (NEDs and EDs) and its

presidency (the dual direction). Similarly, the effectiveness of board committees depends on several factors, including their composition, roles authorities and responsibilities, etc. This descriptive study revealed that most of the mechanisms used by the UAE national commercial banks are those that forced by the laws and the regulations, all banks under investigation have a board of directors, an auditor, an audit committee, credit committee and an executive committee. However, many banks have other committees created voluntarily to enhance corporate governance systems in these banks such as risk management committee, and nomination and remuneration committees. UAE national commercial banks' boards of directors are increasingly more independent, particularly with the domination of NEDs on the board, and the lack of board duality. Also, results indicated the importance of internal governance mechanisms versus external ones. Finally, the paper reflected that significant improvements have been made by UAE banks regarding corporate governance, but more efforts remains to be done, such as the full transparency of banks' activities and complete accountability. In addition to, the need of UAE banks to opting for specific performance measures and standards for evaluating the board performance.

8 Future Research

This study explores corporate governance mechanisms in UAE national commercial banks, particularly internal norms due to the lack of information on external governance mechanisms in banks' annual reports and other published materials. Therefore, there research themes on corporate governance can be investigated in the future, such as the degree to which these banks adhere to external corporate governance mechanisms, the impact of corporate governance norms used by UAE banks on the bank performance, corporate governance mechanisms opted for by banks across Gulf countries. Additionally, one of the corporate governance themes that need more exploration and investigation is corporate governance in UAE and Gulf family businesses; particularly the empirical research in this area is so limited. Furthermore, behavioral patterns or the actual behavior of banks, in terms of measures such as performance, efficiency, financial structure, transparency, accountability and disclosure need further investigation.

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