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CORPORATE GOVERNANCE IN BANKING SECTOR: CASE STUDY OF YEMEN

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Abstract

In the past decades, the talking about corporate governance and its effects on organizational performance and risk reduction were increasing especially in developing countries. This paper was highlighted on the reality of the corporate governance in Yemen through discussing the policies and instructions which are adopted by the financial authorities and banks. We choose the adoption of corporate governance in the banking sector as the importance for this vital industry in economic stability. This study followed the theoretical framework method in the analysis the laws, regulation, and procedures which developed by the central bank of Yemen. Also, analysis the issues and challenges of adoption the corporate governance in the banking sector. We found that the financial authorities in Yemen achieved a remarkable development in launched rules, laws and regulations, while the practice for these rules from the banks still in the minimum level, and this refer to unstable in the political issues in the country since 2011. We recommend more research regarding the effect of adoption corporate governance in the banking sector in developing countries.

Keywords: Corporate governance; Basel Committee; Central bank of Yemen; Banking; Risks

INTRODUCTION

The financial inflictions happening in many prominent institutions around the world have resulted in calling for necessary regulations, standards and ethical and professional principles for achieving trust and reliability in the financial data required investors. In turn, this has led to the emergence of corporate governance concept.

The attention to corporate governance started after a series of financial crises to gain momentum. In the past few decades, the corporate governance has become one of the essential issues in several developed and developing countries. Interesting in corporate governance has been felt in regional and international companies and organizations. In 2008, an agreement between Businessmen Club of Yemen and Center of International Private Enterprise was signed to start implementing corporate governance project in Yemen funded by Middle Eastern Partnership Initiative. This paper will discuss corporate governance in Yemen in general and banking sector in particular.

The Yemeni banking sector consists of the Central Bank of Yemen (CBY), which is at the forefront of the banking structure, which formulates and operates the monetary policy and controls the transfer of currencies abroad. It is the lender of last resort, exercises supervisory authority over commercial and Islamic banks and serves as a banker to the Government. In addition to the CBY, the financial system in Yemen is comprised of 11 commercial banks (four privates domestic, five private foreign banks, two state-owned), six Islamic banks and two specialized state-owned development banks (CBY, 2013).The number of banks branches increased from 129 at the end of 2008 to 305 at the end of 2013. The total number of ATMs operated in Yemen by Islamic and conventional banks increased from 300 in 2008 to 980 in 2013. The CBY issued new licenses for Money Exchangers. The number of these permitsrisen from 564 in 2008 to 605 in 2013,Nonbank financial sector in 2014 comprises 15 insurance companies, four pension funds operated by state agencies. Also, there are 19 active microfinance institutions in Yemen, most of which werecreated by the Government ‘s Social Fund for Development (SFD).

Many banking laws govern the banking system in Yemen; the Central Bank Law, the Commercial Bank Law, and the Islamic Bank Law. These laws are applied together to regulate the banking business in Yemen

In this paper, we explained the experience of Yemen in corporate governance, troubles which caused late of Yemen in implementing corporate governance. Also, the essential laws and regulations for implementing corporate governance in Yemen, evolution, and up-growth of corporate governance in Yemen. In addition to corporate governance in Yemen banking sector and how to evaluate Yemen banks performance.

LITERATURE REVIEW

We showed a set of new and essential studies which addressed the impact of corporate governance on bank performance. Orazalin et al. (2016) studied the effect of corporate governance practices such as board characteristics, ownership structure, disclosure and Chief Executive Officer(CEO),education on the operating performance of Russian Banks; this study revealed a positive impact of corporate governance on bank performance before and after the financial crisis.

Darko et al. (2016) examined the relationship between corporate governance and firm performance of listed Ghanaian companies. They found out that ownership concentration and female representation on board have a positive impact on performance. Also, there is no evidence to support theeffect of board size and audit committee size on performance; there is significant evidence to support the fact that audit committee frequency and independent directors both adversely affect firm performance.Ahmadi and Bouri (2016)confirmed the positive and significant effect of the fixable spending account FSA on the level of financial disclosure and showed that firms with a high level of financial disclosure are those who have an independent board of directors, auditor, and joint audit.

Appuhami and Bhuyan (2015)indicated that CEO duality, board composition, and remuneration committee composition are significantly associated with Intellectual Capital(IC). In contrast, there is no evidence that audit committee and board size composition affect IC. Shahwan (2015)suggested that the quality of CG practices within Egyptian listed firms is relatively low and the results do not support the positive association between CG practices and financial performance. Also, there is an insignificant negative relationship between CG practices and the likelihood of economic distress.

Xu_Dong et al. (2015) found that the promulgation of the code of corporate governance CCG in 2002 has had a positive impact, but the Share Structure Reform (SSR),which reformed in 2005 has had little effect on listed firms' earnings quality in China. These results hold good after controlling for some ownership, governance and other variables and estimating models with multiple measures of earnings' quality

Moreover, Haji and Mubaraq (2015) there were still cases of non-compliance with the requirements of the code such as the one-third Independent Non-Executive Director (INDs) requirement even after the revised code. While the regression models indicated a marginal significance of board size and independent directors before the revised system, the results indicated all corporate governance variables have a significant adverse relationship with at least one of the measures of organizational performance. Independent chairperson, however, showed a consistently positive impact on firm performance both before and after the revised code. Also, ownership structure elements were found to have a negative relationship with either accounting or market performance measures, with institutional ownership showing a consistent negative impact on firm performance. Firm size and leverage, as control variables, were significant in determining corporate performance.

Bukhari et al., (2013) pointed out that the most significant dimensions, which affect the corporate governance in Islamic banks,are Board of Directors (BOD), and Sharia'ah Supervisory Board (SSB).While the significant factors for Islamic banking windows are almost all dimensions of corporate governance, the results indicated that there is a significant difference between Islamic banks and Islamic banking windows regarding the Board of Directors and Saria'ah Supervisory Board. In contrast, no significant difference is seen for the rest of the factors.

Bokpin (2013) addressed that the overseas banks are more cost-efficient than local banks, but not more profit-efficient. Nevertheless, external banks are more profitable than local banks and have better quality loans. Where themanagerial ownership leads to the cost inefficiency of banks. And banks with inside ownership are unprofitable overall but keep a high loan quality. Governance (a larger board size) powerfully improves profit efficiency, but a little worsens cost efficiency of banks.The capital adequacy ratio and bank size are both significant predictors of bank efficiency in Ghana.Also, Nyamongo and Temesgen (2013)found out thata large board size impacts on performance negatively; the existence of independent board directors enhances the performance of the banks, and there is no evidence that chief executive officer CEO duality or otherwise has an impact on the performance of commercial banks in Kenya.

Moustafa (2007) concluded that there are significant differences between banks regarding the structure of corporate governance when analyzing banks with busy boards and others with less-busy boards. Outstandingly, the study showed that bank risk is positively related to multiple board appointments of bank directors. Besides, Cooper et al. (2015) found out that there is a significant impact for the debt ratio (total debt/total assets), national ownership, and the payout dividends ratio on the companies performance. Whereas, board size, institutional investors, the firm size (sales), and the audit type showed a non-significant impact. Bahreini et al. (2013) testified the impact of corporate governance characteristics especially the board of directors and audit committee on the performance of Malaysian banking sector. They found that three out of six corporate governance characteristics variables were discussed in this study such as board size, audit committee size, and audit committee meeting have a positive relationship with the performance of the bank. Percentage of the independent non-executive board of director and proportion of independent non-executive audit committee members have a negative correlation with the performance of the bank. The result showed that corporate governance mechanisms do influence the bank performance

Fanta et al. (2013) examined the relationship between selected internal and external corporate governance mechanisms and bank performance as measured by ROE and Return on Assets ROA. The findings indicated that board size and existence of audit committee in the board had a statistically significant adverse impact on bank performance; whereas bank size had a statistically significant positive impact on bank performance. Also, capital adequacy ratio, as a measure of external corporate governance mechanism, had a statistically significant positive effect on bank performance.

Anon (2012)testified the hypothesis that corporate governance positively affects the performance of banks. The study pointed out that poor asset quality and loan deposit ratios negatively affect financial performance and vice versa. Bouheni (2016) presented an analysis of how regulatory and supervisory policies affect risk-performance nexus. The study found out that the effect of risk on banking performance is conditional by the improvement of banking governance in Europe.

Al-matar et al. (2014) addressed that the board size, board meeting, audit committee independence and executive committee independence have a significantly positive relationship with Tobin`s Q. On the other hand, legal counsel and board independence are significantly and negatively related to Tobin`s Q. A positive but insignificant relationship is found between CEO tenure, CEO compensation, audit committee size, and the firm performance (Tobin`s Q). Board change, the role of the secretary on the board, audit committee meeting, executive committee size and executive committee meeting is revealed to have a negative but insignificant association with firm performance (Tobin`s Q). Al-Baidhani (2013) concluded that the corporate governance has a significant relationship with the bank profitability. Board meetings and bank age have positive and significant effects on ROE. Meanwhile, bank size and board independence have negative and significant effects on return on assets ROA.

Cao et al. (2015) found out that the corporate governance relationship with the audit effort was weak. However, the risk-based mode implementing required by the new auditing standards has significantly improved the relationship between audit effort and corporate governance. Demirgüç-Kunt et al. (2008) found out that banks receive more favorable Moody's financial strength ratings in countries with better compliance with Basel Core Principles related to information provision. The results are robust to controlling for broad indexes of institutional quality, macroeconomic variables, sovereign ratings, and reverse causality. Hartman et al. (2007) found some characteristics of the internal governance system have significant influences on motivation and indirectly to organizational commitment, whereas others, quite against theoretical expectations, have not.

Alagathurai and Nimalathashan (2013) found out that all variables of corporate governance positively correlated with return on equity in state banks as well as, in private banks, except for Board diversity (BD) and Board Meeting Frequency (BMF).Where other variables have strong negative relation with ROE, which is significant at the 5percent level of significance. Similarly, except BMF other variables have a negative relationship with ROA in state banks. Private Banks also show the same relation except for the variable BD. BD has a strong negative association with ROA in state banks which is significant at 5 % level of significance, but in private banks; the positive relationship is denoted by BD which is not substantial. Manzaneque et al. (2016) found that there is a negative relationship between board size and the likelihood of financial distress. This result interpreted as a form of creating diversity and to improve getting to the resources and information, specially in contexts where the ownership is highly focused, and large shareholders have a highpower to effect the board structure. The study found out that ownership concentration does not have a significant impact on financial distress likelihood.

METHODOLOGY

This study based on theoretical analysis of corporate governance issues and implementation in Yemen. We used several sources in our analysis such as Basel Committee, Central Bank of Yemen, Yemen Business Club, financial reports and previous studies related to corporate governance. We also highlighted on the disadvantaged for late in implementing corporate governance and the regulations, rules and other procedures which adopted from the CBY and other formal institutions to enhance corporate governance in the banking sector as a vital sector on economic growth and stability.

Corporate Governance Issues, Regulations, and Challenges

Corporate governance started to attract attention after the financial crisis which swept several countries around the world. Therefore it has become an immediate need as a result of liberalization international stock market and an accelerating speed characterizing globalization which has opened new doors and channels for investors to secure massive profits. It has become essential for investors to look for organizations with sound structures and which practice governance for organization management and allowing investors to participate in supervising them. This has contributed to making Yemen like other countries give more attention to corporate governance. Despite the competition of developed nations in issuing rules and regulations governing corporate governance in the 1990s. The Republic of Yemen like other Arab countries began recently to give attention to this concept.

Troubles of Late Interesting in Corporate Governance

Yemen recently began interestingly in corporate governance due to several reasons which can be listed as follows:

1. Lack of awareness in corporate governance structure in Yemen joint stock companies.
2. The absence of implementing corporate governance and its importance.
3. Yemen has no stock markets which are the cornerstone of implementing corporate governance.
4. The small-sized economy in Yemen with unorganized projects, individual property, and family organizations. Also, most of the corporations in Yemen are closed ones belonging to specific family members.
5. Public organizations and authorities have no interest in adopting this concept, and only attention has been limited to the civil society organizations such as Yemen businessmen club.
6. Supervisory and regulatory authorities including ministries of industry and trade and the central bank of Yemen do not encourage companies and banks to implement governance system or hold training courses on governance.
7. The business sector in Yemen faces several obstacles mainly poor institutional and administrative structure in most corporations.

The Essential Laws and Regulations For Implementing Corporate Governance Principles

Several factors have resulted in issuing some laws and legislation by the government of Yemen mainly the focus of the government on encouraging and attracting foreign investments to Yemeni markets. Privatization, the bankruptcy of some Yemeni companies and banks, including National Bank for Trade and Investment (a private sector bank). Moreover, the collapse of some state-owned enterprises including General Corporation for External Trade and Cereals and Textiles Factory, and the state fighting of corruption. This came under the framework of financial, economic and administrative reform program adopted by the state since 1995 which realize the basis for corporate governance in Yemen. Those laws are seen as the mechanisms for realizing corporate governance in Yemen. Laws concerning fighting corruption, financial liabilities, bidding tenders, and completing reconstruction of civil service apparatus and central apparatus for control and auditing are considered as important foundations for the application of governance principles at the level of public and private sectors and civil society organizations. The most important of those laws are listed as follows:

Commercial Companies Law in 1997.This law specifies the way companies are established and managed, how the company board of directors is formed and what are its duties and connection to stockholders and general assembly. This law includes articles concerning auditor in the joint stock company. It also indicates the company's relationships with other parties and bodies.

Public Companies and Institutions Law in 1991: is amended by law No. 7 in 1997, this lawexplains how to manage a concerned board runs the activities of public companies and Institutions. The selection of board members, the regulations over their salaries, and the duties and responsibilities of the board are indicated in this law. This is one of the fundamental foundations of strengthening and supporting corporate governance in Yemen. This lawis seen as an essentialbasis for practicing the principle of The Responsibilities of the Board which is a principle of corporate governance of the Organization of Economic Cooperation and Development (OECD).

Privatization Law in 1999: Corporate governance and the ethical practice of its principles is important for the economy in that it helps in achieving high just and permanent growth rates which in turn lead to flourishing stock market and increasing investment rates. Besides, corporate governance supports the private sector and its competitive ability.

Anti-Corruption Law 39 in 2006: anti-corruption is essential in corporate governance to ensure honesty, transparency, and efficiency of internal and external auditing as mentioned in this law.

Investment Law in 2010: Companies that follow corporate governance principles enjoy an increasing trust of investors since abiding by such tenets ensures safeguarding their interests. Hence, it is observed that investors in companies that apply governance principles correctly may think deeply before selling their shares in such companies even when under crises. This helps make this sort of corporations survive at times of crises.

About encouraging the flow and attraction of foreign investments into Yemeni markets and facilitating business for foreign investors, Investment Law No. 15 in 2010 was issued by the Yemeni legislature. It includes a set of particular motives for investment encouragement. This law aims at attracting, attracting and developing local and foreign investments in line with the frame of the state general policy, the national goals and priorities in the field of economic and social development, and the encouragement and regulation of investing Yemeni, Arab and international capitals. Furthermore, the government grants Yemeni, Arab and foreign investors the freedom of investing in various projects. It also guarantees equal indiscriminating treatment of local and foreign investors in all rights, obligations, and freedom of investment in any of the economic sectors. This includes total or partial ownership of the investment project as per the rules of this law that has been issued to conform to recent international developments in the field of investment, and in line with laws of Gulf Cooperation Council Countries and demand for joining World Trade Organization.

Laws must be focusedon, and justice has to be there while applying such rules so that the state can wisely run the economy in light of events and developments to create the needful atmosphere for implementing corporate governance on the level of Yemeni companies suffering from detrimental administrative practices. We may need to make amendments to these laws as well. Other requirements need to be developed such as bankruptcy announcement law, stumbled companies law, financial stock market law, competition and monopoly law, and other regulating laws for the function of corporations. This makes the legal framework conform to the best international practices in corporate governance as, to give an example, the principles of Organization of Economic Cooperation and Development (OECD) in corporate governance. It is noteworthy to point out that there is no point in issuing laws if they are not applied and executed by qualified, honest cadre.

Evolution and Up-Growth of Corporate Governance In Yemen

The interesting in corporate governance in Yemen began in 2008 by Yemen Businessmen Club (YBC) and Polling Center, a civil community non-profit organization. Despite the importance of corporate governance in development, the attraction of Arab and foreign investment in Yemen and openness to the international market, it has not been adopted by official authorities supervising and controlling commercial and financial sector in Yemen. It is only the YBC which took the initiative by holding various forums and conferences on the reality of Yemeni companies and the importance of governance for achieving better performance levels and preventing risks. The Conference on Institutional Governance held in 2008 in collaboration with Center for International Private Enterprise (CIPE) is an example in this connection. In 2008, an agreement between YBC and CIPE was signed for starting corporate governance project funded by Middle Eastern Partnership Initiative (MEPI) in Yemen. Consequently, the first conference on corporate governance was held on February 6, 2008, under the title “Institutional Governance: The Present Reality and The Future” which aimed at the following:

1. Defining the bases and principles of governance.
2. Identifying possible means for applying governance principles in Yemen.
3. Identifying governance reality in Yemen and comparing that with governance reality in neighboring countries.

The most important recommendations of this conference on governance in Yemen are as follows:

a) Spreading awareness of governance among concerned parties of companies and institutions. This plays a role in making decisions which contribute to financial stability and economic growth in the Republic of Yemen.
b) Applying governance principles in public and private sector institutions and family companies. This helps in institutional stability and growth and attracting investment as well.
c) Training members of boards of directors, supreme leadership in public and private institutions on efficient application of governance principles.
d) Conducting necessary studies and research to identify the extent of regular implementation of corporate governance and to explain ways of facilitating hardships facing them.
e) Calling official authorities to encourage the application of governance principles in governmental and private institutions by all possible means.
f) Providing governance- relevant evidence to help officials in private and public institutions in promoting awareness of governance and its principles.

As a result of this conference and following its recommendations, corporate governance workshop was held on 10 February 2008. The most important outcome of that workshop is forming a work team of corporate governance in February 2008 comprising 25 members from public and private sectors as well as civil society organizations. That work team aimed to gather major influential groups from national industry, businessmen community, academic and media circles, financial auditors and civil society organizations. To promote awareness of the importance of corporate governance, increase knowledge in governance along with relevant technical experiences, conduct research and significant studies, reform policies and develop a guidebook for improving the application of corporate governance in Yemen.

On 9 April 2008, a workshop of governance work team was held where three committees were formed as follows:

i. Awareness committee.

This committee aims to work with interested authorities to design a particular website for “Yemen Governance.” The site aims at defining governance, following up developments, activities, and work of governance enterprise in Yemen, holding necessary functions that define governance and spreading and promoting awareness of governance culture among all sections of society in cooperation with particularly the media and journalistic sector.

ii. Guidebook drafting committee.

This committee was formed with the aim of benefiting from the governance guidebook issued by several friendly countries like Egypt, Lebanon, and Gulf countries. In turn, this enables the committee to prepare the guide of corporate governance in Yemen by Yemeni environment and take the help of Arab and foreign experts in this field to contribute to drafting and formulating governance guidebook. An Arab expert was invited to participate in the second meeting of governance work team which was held on 13 October in 2008.

iii. Legal committee.

The task of this committee was to contract with concerned authorities for conducting a study on the legal, organizational environment in Yemen concerning corporate governance. In support of these boards, and in coordination, cooperation with CIPE, YBC and Middle East Partnership Initiative, a contract was made with KPMG consultation office. This office, one of the largest companies of chartered accountants in Yemen to help in preparing a study on legal, organizational environment in Yemen concerning corporate governance.

In this workshop, the aim was to issue a guidebook for corporate governance in Yemen., where the role, aims and framework of work team have been specified.

Governance Framework on Yemen Banks

The Central Bank of Yemen makes efforts in the framework of enhancing corporate governance standards and practices in Yemen banking sector, as well as seeks to keep abreast of developments in the international supervisory standards in this field.

In 2008, the Central Bank of Yemen issued “Banks Governance Guide in the Republic of Yemen” which had been prepared with supporting of the International Finance Corporation (IFC).And in cooperating with Yemen Business Club (YBC) under the international standards issued by Basel Committee on Banking Supervision. In addition to the principles of corporate governance released by Organization for Economic Cooperation and Development (OECD) and the experiences of some Arab countries in the area.

The effective practicing for corporate governance is considered one of the fundamental factors for enhancing confidence in the banking sector and of the critical factors for improving banking sector and macro-economy. The sound practices in banks governance represent in distributing powers and responsibilities to ensure regulating bank business by the board of directors and executive administration.

Also, the implementing of sound corporate governance standards contributes to enhancing the efficiency and effectiveness of the internal controlling system. Where ensures the board of directors control, executive administration control and directly controlling on the bank activities to provide the independence of internal auditing, risk management, and compliance functions to enhance the role of control body in the Islamic banks.

Banks governance guide of Yemen contributes in establishing and developing the standards and regulations of banks governance in Yemen, also, to help the board members and executive administration in supervising bank activities and improving the practices in banking sector business to serve the general interest of the banking sector and national economy.

The banks of Yemen should provide banking services which meet the needs and requirements of society in reasonable costs and initiate to provide funds. Therefore, supporting and encouraging the small and medium enterprises particularly those concerned with recruiting and training the citizens and developing their skills, also, to following up appropriate social policies in the field of protecting the environment, health and education.

We can summarize the governance system according to the corporate governance guide for banks issued by the central bank in the following figure:

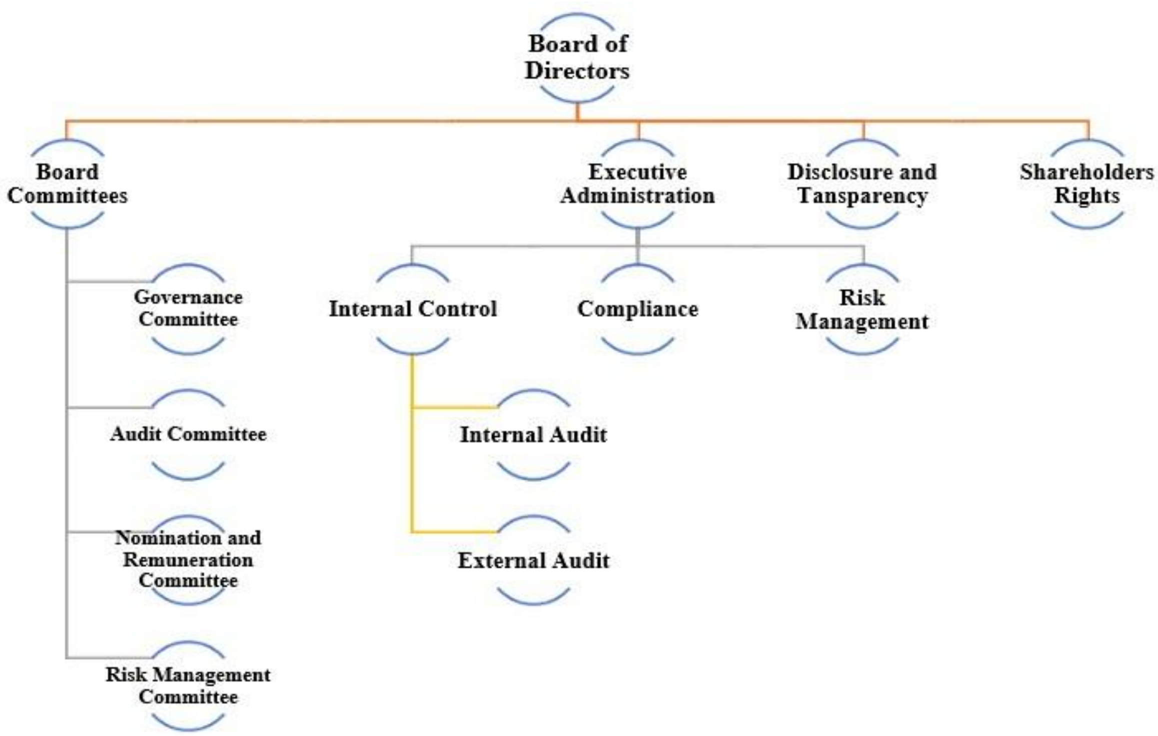

Figure 1: Flow chart of Banks Governance

Source: Compiled by authors

CONCLUSION AND POLICY IMPLICATIONS

This study stated the experience of Yemen in corporate governance in the banking sector, troubles which caused late of Yemen in implementing corporate governance. The essential laws and regulations for implementing corporate governance in Yemen, evolution, and up-growth of corporate governance in Yemen, corporate governance in Yemen banking sector and how to evaluate Yemen banks performance.

We found that the financial authorities in Yemen achieved a remarkable development in launched rules, laws and regulations, while the practice for these rules from the banks still in the minimum level, and this refer to unstable in the political issues in the country since 2011.

We recommend more research (empirical and theoretical) regarding the effect of adoption corporate governance in the banking sector in developing countries in regards to capturing all factors which influence the corporate governance. Furthermore, we point to some key points or questions requiring future research as follows:

1. The role of safe environment in implementing corporate governance in developing countries especially in Yemen.
2. The effect of governance and audit committees in increasing the profitability of banks and improving the performance of financial institutions.
3. The extent of commitment to Basel committee requirements in the banks of developing countries.
4. The role of disclosure and transparency in implementing corporate governance.

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