

## **The Effects of Corporate Governance Requirements on Jordan Banking Sector**

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### **Abstract**

*This study seeks to understand how Jordan banking sector is affected by the Corporate Governance (CG) requirements released by Basle Committee on Banking Supervision (BCBS) and Organization for Economic Cooperation and Development (OECD). The study reveals that Jordan Banking Sector has been paying CG a great deal of attention. Therefore, the Central Bank of Jordan (CBJ) issued Bank Directors Handbook of CG which has been developed with the objective of enhancing the CG of Jordanian banks. Further to issuing the Handbook, the CBJ is continuing its efforts to enhance CG by preparing the CG Code which is intended to promote international best practice in the CG of Jordanian Banks, and asked each bank to keep this code under review and be developed and amended as required from time to time to meet the changing needs and expectations of the bank and the marketplace. As a result, banks in Jordan comply with CG requirements by acting in accordance with a request from the CBJ based on BCBS and OECD guidelines and requirements which enhance the CG procedures. Therefore, CG continues to gain attention and importance from parties concerned in Jordan but many steps need to be done in the future.*

**Keywords:** Corporate Governance, Governance Requirements, Governance Environment, Banking Industry, Jordan.

### **1. Introduction**

Corporate governance requirements are being developed in many countries. Most of the proposals have come from the USA and the UK and its former colonies where shares are widely held. Corporate governance is not about power, but about ensuring that decisions are made in the best interest of the organization<sup>1</sup>. In this situation, there has to be some control and monitoring on behalf of the directors. One of the pioneering efforts to produce a standard evaluation measurement methodology is by the German Society of Investment Analysis and Asset Management (DVFA). The scorecard for German corporate governance is designed as a professionally suitable analytical tool for analysts, investors and companies for evaluating factors comprising the basic elements of the corporate governance. The German quantitative model is based on the German legal framework. It ignores important elements such as internal control and core values<sup>2</sup>.

Furthermore, the US congress responds to the collapse of Enron and Arthur Anderson, the accounting failure of WorldCom and the bankruptcy of Global Crossing by enacting a law, the Sarbanes-Oxley Act of 2002, to impose good corporate governance and ethical business practices on publicly traded companies. Development in other countries, including Jordan leads to a wider ownership of shares of companies, and this will lead to the extension of corporate governance requirements in those countries. Therefore, this study reviews the nature and purpose of corporate governance, and demonstrates how corporate financial reporting is a significant part of effective governance, and applying this on Jordan banking sector, do they comply with corporate governance requirements. By doing so, this study reinforced the key elements of widely accepted and long-established corporate governance principles that guide the actions of the directors, managers and supervisors of a diverse range of banks in Jordan.

### **2. Theoretical Background**

#### **2.1 The Corporate Form**

- (1) There are three primary forms of business organizations: (1) the proprietorship, (2) the partnership, and (3) the corporation. The dominant form of business is the corporate form, in terms of the aggregate amount of resources controlled, goods and services produced, and people employed.

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<sup>1</sup> Harvard Business Review on Corporate Governance provides the reader with useful information on this concept.

<sup>2</sup> Please refer to "scorecard for general corporate governance" on <http://www.dvfa.de>

Although the corporate form has a number of advantages (as well as disadvantages) over the other two forms, its principle advantage is its facility for attracting and accumulating large amounts of capital to be used as capital stock or share system, which will be briefly considered next.

### **The Capital Stock or Share System:**

Stockholders' equity in a corporation is generally made up of a large number of shares. Within a given class of stock, each share is exactly equal to every other share. Each owner's interest is determined by the number of shares possessed. Each share of stock has certain rights and privileges that can be restricted only by a special contract at the time the shares are issued. One must examine the articles of incorporation, stock certificates, and the provisions of the state law to ascertain such restrictions on or variations from the standard rights and privileges. In the absence of restrictive provisions, each share carries the following rights:

- (1) to share proportionately in profits and losses,
- (2) to share proportionately in management (the right to vote for directors),
- (3) to share proportionately in corporate assets upon liquidation,
- (4) to share proportionately in any new issues of stock of the same class, called the preemptive right.

The great advantage of the share system is the ease with which an interest in the business may be transferred from one individual to another. Individuals owning shares in a corporation may sell them to others at any time and at any price without obtaining the consent of the company or other stockholders. As the number of stockholders grows, the need may develop for a more efficient system that can handle large numbers of stock transactions.

### **2.2 Defining Corporate Governance**

A decade ago, the term "corporate governance" would have been rarely heard, let alone understood, in many boardrooms. Few academics and management paid attention to this term that basically describes the way in which companies are structured or "governed" (O'Regan, 2006). Therefore, this study tries to give attention to this issue. Because corporate governance is a familiar and usually undefined term, it is unsurprising that it appears to have as many meanings as it has users. In an everyday sense, the verb to govern is typically defined as "ruling by authority". It is commonly associated with the activities of the state. In the corporate sense, however, corporate governance seems to be a term used almost universally in a less stringent sense of directing, regulating, or controlling. This broad definition attempts to reflect the modern company as an organization managed on behalf of a variety of stakeholders including its shareholders. Scholars (e.g. Lee, 2006) have a clear definition of corporate governance as

*"the formal mechanisms of directing, supervision, and control put in place within a company in order to monitor the decisions and actions of its senior managers and ensure these are compatible and consistent with the specific interest of shareholders and the various other interests of stakeholders who contribute to the operations of the company."*

This definition indicates that formal mechanisms of direction, supervision, and control are intended to hold senior managers accountable to shareholders and other stakeholders. Accountability in this sense means that these managers are expected to provide a regular reckoning or account of their decisions and actions. In other words, having been given responsibility by its shareholders for managing the company, senior managers are held responsible for that management. This means that, within a company, there are various connected lines of responsibility, from employees and staff to junior managers to senior managers to the board of directors to the shareholders and, more indirectly, to other stakeholders.

The term "governance" in this context is used to describe the way in which a company is structured and controlled, the manner in which this accommodates the relative rights of owners, managers, financiers and others. The resulting "balance of power" is regularly extended and tested by shareholders, managers, boards of directors, government, markets, employees and others with a stake in the company, with the result that the governance structure constantly mutates in response to political, social and economic pressures where others (e.g. Lex, 2005) see corporate governance rules are designed to protect capital, not the state, labour, or the consumer. Taking a broad perspective on corporate governance, Gillan and Starks (1998) define corporate governance as the system of laws, rules, and factors that control operations at a company. The simple balance sheet model of the firms, depicted by Gillan and Starks (1998), captures the essence of a separation between capital providers and those who manage the capital. The left-hand side of the balance sheet comprises the basic of internal governance. For example, management, acting as shareholders' agents, decides in which assets to invest, and how to finance those investments. Also, the Board of Directors, at the apex of internal control systems, is charged with advising and monitoring management. The right-hand of the balance sheet introduces elements of external governance arising from the firm's need to raise capital.

Irrespective of the particular definition used, researchers often view corporate governance mechanisms as falling into one of two groups: those internal to firms and those external to firms and this separation creates the demand and the need for corporate governance structures and guidelines.

### **2.3 The Demand for Corporate Governance Structures**

Corporate governance deals with the mechanisms that ensure investors in corporations get a return on their investments as Shleifer and Vishny (1997) put it. Therefore, the suppliers of finance use corporate governance to ensure that they will get a return on their investment which reflects the important link between shareholders and the board. Shareholders, the residual claimants, elect board members and boards, as established in state law and owe a fiduciary obligation to shareholders. Gillan (2006) provides a comprehensive perspective of the firm and its corporate governance and argued that firms are more than just boards, managers, shareholders, and debtholders and depicted other participants in the corporate structure such as employees, suppliers, customers, and the political environment such as laws and regulations. This view captures the realities of the governance environment. For example, in the USA, the Sarbanes-Oxley Act of 2002, demonstrate that law and politics have important influences on both corporate governance and the way those firms operate. This study expands the basic framework further to examine a broader set of governance influences which are consistent with the definition of Gillan and Starks (1998) and incorporates elements that many may not traditionally view as being part of corporate governance structures but may have a minimum effect on corporate governance such as the Board of Directors, managerial incentives, capital structure, and law and regulations.

### **2.4 The Need for Corporate Governance Guidelines**

A series of large and costly corporate scandals focused attention on the possibility that many of the problems could be traced to structural factors and suggested that the failure, or inability, of boards of directors to control and monitor business, laxity in accounting standards had played important roles. Furthermore, where shares are widely held, and management of the company is delegated to directors who are not major shareholders of the company, there is a need for corporate governance guidelines. The 'theory' of listed companies is that the shareholders own the company. However, there are too many shareholders to run the company, and they may not have the expertise or desire to run the company. So, the task of running the company is delegated to the directors. The 'duty' of the directors is to run the company in the best interest of the organization, and in a way which maximizes the long-term return to the shareholders (Elliott and Elliott, 2006). In doing this, corporate governance guidelines are developed so that it can be seen whether the directors are maximizing returns to shareholders, that business risk is set at a reasonable level, that a director or the board of directors does not become dominant to the detriment of the shareholders, and that the remuneration of the directors is reasonable.

Disclosure of this information is made in the company's annual financial statements. Information must be checked by an independent auditor to ensure the reliability of this information. In this regards, corporate governance in the UK and in most Western countries does not depend entirely on legislation from government. There is also a regulatory system dealing with the accounting practices used in the production of corporate financial statements. Legislators prefer to leave accounting matters to public accountants and their institutions. Whereas Companies Acts contain detailed provisions relating to the type of accounting information to be disclosed to shareholders, they do not usually prescribe all the specific accounting practices to be adopted in preparing such information. As a consequence, the public accountancy profession and its institutions have gradually developed a system of accounting standards that mandate particular ways in which accounting numbers are to be calculated (for details, see Lee, 2006, pp.25-27).

### **2.5 Corporate Governance Recommendations and Requirements**

To cope with corporate governance guidelines, Organization for Economic Cooperation and Development (OECD), the Commonwealth<sup>3</sup>, the UK, the USA<sup>4</sup>, and Jordan recommended a list of points for listed companies to comply with as shown in Table (1).

#### **Table (1) about here**

The above listed points are recommendations and not requirements. Thus, they are not as strong as statutory requirements or even accounting standards.

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<sup>3</sup> "Principles for corporate governance in the commonwealth", Commonwealth Association for Corporate Governance Guidelines, November 1999.

<sup>4</sup> Corporate governance requirements for other countries are either undeveloped or far less developed.

However, stock exchange will expect listed companies to comply with the recommendations, and failure to comply with some of them may have an adverse effect on the company's share price. Generally, the recommendations have been drawn up by committees comprising directors and representatives of listed companies, their auditors, and financial institutions which invest in the shares. There is little, if any, representation of 'ordinary' shareholders on these committees. So, the recommendations may be biased. Many companies and their directors would prefer not to have to comply with corporate governance requirements; compliance limits its independence, and there are additional costs involved in setting up and monitoring corporate governance systems within the company. However, pressures from governments, the general public, shareholders and financial institutions will mean that directors have to accept some corporate governance requirements. The agreed corporate governance requirements will be a compromise between the pressures of the directors of the listed companies (who would have few, if any, requirements) and those of the government, shareholders and financial institutions (who would prefer to have detailed corporate governance requirements), (for details, see Elliott and Elliott, 2006 pp. 594-607).

In this regard, there are four interesting correlations when considering the development of corporate governance requirements in different countries. These are:

- (a) The ratio of the value of listed companies to the country's Gross Domestic Product (GDP). The higher this ratio, the more developed are the corporate governance requirements, also, the more pressure there will be from equity investors for good corporate governance and transparency (Elliott and Elliott, 2006). The UK percentage of over 130%, 142% in 1993 and 1996 was one of the reasons why there was an early interest in good corporate governance in the UK. Since 1996, there has been a growth in equity investment in other countries which has led to a similar pressure for greater transparency, good corporate governance and improved investor education<sup>5</sup> ;
- (b) How widely the shares of listed companies are held. If a large number of financial institutions and individuals hold shares in listed companies, there is a greater need for corporate governance requirements. In the USA and the UK, a large number of financial institutions and individuals hold shares in listed companies, so there is a greater need for corporate governance requirements. In Japan and most European countries (except the UK), shares in listed companies tend to be held by a small number of banks, financial institutions and individuals. Where there are few shareholders in a company, they can question the directors directly, so there is less need for corporate governance requirements. A further related factor is that USA and UK companies tend to have a low gearing, so most of the finance is provided by shareholders. However, in other countries the gearing of companies is much higher, which indicates that most finance for companies comes from banks. If the majority of the finance is provided by shareholders, then there is a greater need for corporate governance requirements than if finance is in the form of loans where the lenders are able to stipulate conditions and loan covenants, e.g. the maximum level of gearing and action available to them if interest payments or capital repayments are missed;
- (c) Cultural consideration. The USA and the UK and its former colonies (Australia, Canada, Singapore, and Malaysia) tend to have much more developed corporate governance requirements than other countries (Elliott and Elliott, 2006) ;
- (d) The different levels of management in the organization structures of companies. In the UK system, there is just one level of management represented by a board of directors who may delegate to members of the board such functions as remuneration committee and audit committee membership. Corporate governance is achieved by the financial regulatory authorities requiring compliance with a voluntary code of conduct from the directors of listed companies. Other countries have a two-tier system of management with a management (or executive) board responsible for the operational management of the company, and a supervisory board which acts on an ad hoc basis, e.g. approving an important business transaction, and at the year-end when it receives the audit report, and the management report on the activities and dividend proposed by the management board, and approves the financial statements and dividend distribution. This two-tier structure might be seen as providing a greater degree of control than the single-tier system and so there is less need for an imposed code of conduct.

## **2.6 Corporate Governance in Banking Organizations**

Policy makers and regulators have been paying corporate governance a great deal of attention. They recognize the positive role of a good corporate governance system in safeguarding the interests of a wide range of their constituencies and communities (OECD, 1999).

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<sup>5</sup> <http://www.oecd.org>.

In September 1999, Basle Committee on Banking Supervision (BCBS)<sup>6</sup> released its paper on “Enhancing Corporate Governance for Banking Organizations”. To the BCBS committee, the concept of corporate governance in general evokes the set of relationships that exist between a bank’s management, its board of directors, its shareholders and the other stakeholders. It provides the framework in which to establish the strategic objectives of the organization and the means to attain and monitor those objectives accordingly, for the Committee sound corporate governance involves the following seven practices:

- (1) establishment of strategic objectives and a set of corporate values to be communicated throughout the banking industry;
- (2) definition and enforcement of clear lines of responsibility and accountability throughout each bank and banking organization as a whole;
- (3) assurance that board members are qualified for their positions, have a clear understanding of their role in corporate governance, and are not subject to undue influence from management or outside concerns;
- (4) assurance that there is appropriate oversight by senior management;
- (5) effective utilization of the work undertaken by internal and external auditors in recognition of the important control function they exercise;
- (6) assurance that compensation approaches are consistent with the bank’s ethical values, objectives, strategy and system of control;
- (7) conduct of corporate governance in a transparent manner.

The BCBS Committee went beyond the existing practice in the banking industry. It demanded the board to establish the strategy objectives and to set corporate values. Accordingly, in the Committee’s view, the board should create the strategies that will direct the ongoing activities of the bank in question. It should also take the lead in establishing the “tone at the top” and approving corporate values for itself, senior management and other employees. The value should recognize the critical importance of having timely and frank discussion of problems. Furthermore, processes should be established that allow the board to monitor compliance with these policies, and to ensure that deviations are reported to an appropriate level of management. Furthermore, one of the main requirements of the BCBS is the need to empower the board of directors of each bank, and hold it responsible for establishing strategic objectives in the bank, along with a set of corporate values that are communicated throughout the banking organization. Establishing strategic objectives goes beyond the concept of review or oversight of strategy, which was the normal practice among corporate before. Actual implementation of the requirements of the BCBS by the Arab banking industry may require a cultural change and, consequently, a completely different orientation in the Arab financial institutions are managed.

The global banking industry has been transforming and reshaping itself, forcing all major financial institutions to revolutionize their strategic setting process in order to cope with the new and different working conditions externally and internally. Can the Jordan banking industry prosper within the framework of the new realities? The threats and challenges that will face the Jordan banking industry are serious, significant and closing in.

The study revealed the following issues to be of central interest in the context of corporate governance in Jordan: the governance environment; executives and directors; stakeholder management; and ownership and control. To carefully delineate the unique approaches to corporate governance that has evolved in Jordan, it is important to understand the environments that banks in Jordan are embedded in and how these environments are changing. The scope of research here includes examining the reforms and regulations. For example, Are top management behaviors and styles, compensation norms, interpersonal networks, unique or different in Jordan? What are the specific roles of boards of directors? How are board members selected and evaluated? How do various stakeholders negotiate their rights? What is the structure of bank ownership? What is the role of business groups and family ownership in governance? How do family dynamics influence governance?

All these questions bear careful scrutiny for corporate governance in general, and corporate governance in *Jordan in particular*.

### **3. Literature Review**

Recent empirical work focuses on the evolution of board structure over time, and changes in board structure post-Sarbanes-Oxley Act. Chhaochharia and Grinstein (2005, a, b ) focus on recent changes in board structure,

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<sup>6</sup> The Basel Committee on Banking supervision is a committee of banking supervisory authorities which was established by the central bank governors of the group of ten countries in 1975. It consists of senior representative of bank supervisory authorities and central banks from Belgium, Canada, France, Germany, Italy, Japan, Luxembourg, Netherlands, Spain, Sweden, Switzerland, United Kingdom and the United States. It usually meets at the Bank for International Settlements (BIS) in Basel, Switzerland, where its permanent secretariat is located.

finding that board size and independence have increased since the Sarbanes-Oxley Act. Coles et al. (2005b) and Link et al. (2005a, b) focus on board changes over time, and on the costs associated with board changes resulting from the new regulations. Boone et al. (2005) track the evolution of board structure from IPO, and Lehn et al. (2005) examine board evolution for firms surviving since the 1930s. In general, these studies conclude that board size and structure are endogenously determined. In addition, board actions and expertise are attracting increased attention. Agrawal and Chadha (2006) reported that financial expertise on boards limits the likelihood of accounting restatements. Anderson et al. (2005) reported that the market attaches more credibility to earnings announcements when boards and audit committees are both independent and active. Guner et al. (2005) find, building on the work of Booth and Deli (1996) and Krozner and Strahan (2001), that the presence of commercial bankers on boards is associated with the size of loans, while the presence of investment bankers on boards is associated with more frequent outside financings, and large public debt issues. However, the authors find that the presence of financial experts does not necessarily improve shareholder value. Brick et al. (2006), in a similar spirit, examine board characteristics and CEO compensation and they argue and find that excess compensation paid to directors is associated with excess CEO compensation and also is associated with poor future performance.

Also, focusing on compensation Aggarwal and Samwick (2006) develop a model and empirically analyze the relations between incentives from compensation, investment, and firm performance. The authors' optimal contracting model shows that the relationship between firm performance and managerial incentives, by itself, cannot determine whether managers receive private benefits of investment, as in theories of managerial entrenchment. As an alternative, they estimate the joint relationships between incentives and firm performance *and* between incentives and investment. They derive the result that investment and incentives are positively related. Moreover, they find that firm performance is increasing in incentives at all levels of incentives. The authors interpret their findings as being inconsistent with theories of overinvestment based on managers having private benefits of investment. Rather, the results support a view that managers have private costs of investment and, more generally, are consistent with models of underinvestment.

Regarding the capital structure, a number of papers examine multiple classes of stock, which typically entail different voting and cash-flow rights, and corporate performance (e.g. Gompers et al., 2004). Other empirical work on corporate governance and capital structure focuses on the association between governance and the cost of debt. For example, Klock et al. (2005) find that increased use of antitakeover measures is associated with lower costs of debt financing. Furthermore, firms do not operate in a vacuum, but rather under legal constraints. Aspects of the legal and regulatory environment are integrally related to corporate governance, and a large body of research studies the link between governance, law, and finance (Gillan, 2006). Recent empirical works highlight the unique governance issues, for example, Singh and Gaur (2009) use in their comparative study institutional and agency theories to examine corporate governance practices in both China and India. Specifically, they examine how business group affiliation, ownership concentration, and board independence affect firm performance. Using archival data on top 500 Chinese and Indian firms from multiple data sources for 2007, they found that group affiliated firms performed worse than unaffiliated firms, and the negative relationship was stronger in the case of the Indian firms than the Chinese firms. They also found that ownership concentration had a positive effect on firm performance, while board independence had a negative effect on firm performance.

Lattemann, Fetscherin, Alon, Li, and Schneider (2009) address the puzzle of why firms in China, which have a higher level of economic development and thus should communicate more Corporate Social Responsibility (CSR) according to existing theories, communicate less than firms in India? They show, by using data on the largest multinational companies in China and India, that Indian firms communicate more CSR primarily due to a more rule-based governance environment. Also, firms in the manufacturing sector tended to communicate more CSR than firms in service sectors. Shen and Lin (2009) studied the relationships between firm profitability, state ownership, and top management turnover at partially privatized firms in China and they find that firm profitability and state ownership are negatively related to top management turnover only when firm profitability is below target (measured by industry median). They also find that top management turnover has a positive impact on subsequent firm profitability when it occurs under performance below target, but has a negative impact when it occurs under performance above target. In addition, they report that top management turnover under performance below target has a positive impact on subsequent firm profitability when the state is not the largest shareholder, but has no impact when the state is the largest shareholder. Zattoni, Pedersen, and Kumer (2009) examined how reforms led to the dilution of the role of business groups within India and they found that group affiliated firms enjoyed superior performance in the early stages of the reforms, but the performance leveled out in the latter phase.

They also found that older group affiliated firms were better able to cope with institutional transition than younger group affiliated firms, and found that group affiliated service firms were better able to cope with institutional transition than group affiliated manufacturing firms.

#### **4. Methodology**

The rationale for a particular research strategy is grounded in the core assumptions regarding ontology, human nature and epistemology (for review, see Burrell and Morgan, 1979; Morgan and Smircich, 1980). These assumptions provide a rationale as to why research should be conducted in a particular way and how the strategy can be implemented in practice (Morgan, 1983). The present study seeks to see and study the social world from the perspective of organizational actors. The focus was to explain the organizational response to environmental change and the development in the use of control systems in accordance with organizational context. In this sense, organizations and society are viewed as socially-constructed systems of reality where actors develop or create their realities, not only through their own creative activity, but through common experience and interaction with others (e.g. Otley, 1984; Hopper and Powell, 1985).

By adopting this tradition, case studies are particularly suitable for this type of research as a strategy to analyze the social realities of a phenomenon (Hopper, et al., 1986), because the researcher has "no control over events" (Yin, 1984, p. 17) and will focus on a contemporary phenomenon within a real-life context (Scapens, 1990; Ferriera and Merchant, 1992). The banks in Jordan were chosen on the basis of 'openness to society' access and the researcher had received full cooperation and support in his research from formerly university classmates, who were now top managers in the banking industry in Jordan. This research utilized a variety of methods in collecting evidence to get close to the subject and to see the bank's social context from various perspectives, to gather more complete evidence on the issues under close examination, and to generate a rich source of field data by utilizing the "data-triangulation" approach to collect data. In doing this, many techniques were used covering interviews, participant observations, document analysis, archival records, and examination of newspaper reports (for review, see Bawaneh, 1997).

#### **5. Results**

In terms of the governance environment, which is the set of political, economic, and social institutions that facilitate or constrain the choices of governance mechanisms, Jordan is relatively more rule-based due to its long tradition of English common law and a democratic political system. Also, the Jordan economic reform was triggered by external events (the Gulf War that drastically reduced foreign currency inflow and trade) but it has primarily relied on internal resources. Understanding these issues may help us better understand how corporate governance practices are being shaped in the country. The recommendations of the Basle Committee were adopted by several central banks in the Arab region. For example, the Central Bank of Jordan requested in August 2000 that all banks registered in Jordan should comply with the BCBS requirements on corporate governance. Furthermore, it is being asked to demonstrate proper corporate governance, and to compete with more efficient global financial institutions without the safety of sovereign protection<sup>7</sup>. The Central Bank of Jordan, in an effort to enhance corporate governance and improve the internal control of banks in Jordan and the effectiveness of the boards of directors, referred all banks to guidelines issued by The Bank for International Settlements (BIS) in 1999 promoting the adoption of sound corporate governance practices by banking organizations<sup>8</sup>. Therefore, the CBJ summarized the broad guidelines of best practices as follows:

1. Establishing strategic objectives and a set of corporate values that are communicated throughout the banking organization.
2. Setting and enforcing clear lines of responsibility and accountability throughout the organization.
3. Ensuring that board members are qualified for their positions and have a clear understanding of their role in corporate governance and are not subject to undue influence from management or outside concerns.
4. Ensuring that there is appropriate oversight by senior management.
5. Effectively utilizing the work conducted by internal and external auditors, in recognition of the important control function they provide.

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<sup>7</sup> The special characteristics of Arab financial institution that affects the quality of implementation of corporate governance are: financial strength, structure of ownership, limited product lines, and evolving working conditions, for details, see Al-Kharouf, 2000, pp. 34-35.

<sup>8</sup> See Circulars 10/14125 dated August 30, 2000; 10/494 dated March 27, 2002; and 16/2003 dated September 6, 2003, referring to Enhancing Corporate Governance in Banking Organizations. Web site: [www.bis.org](http://www.bis.org)))

6. Ensuring that the compensation approaches are consistent with the bank's ethical values, objectives, strategy and control environment.
7. Conducting corporate governance in a transparent manner.

In the analysis, while these guidelines are generally-accepted global "best practices" for governance, the CBJ gave each bank the opportunities to adopt what is appropriate to the scope and complexity of bank's operations, its traditions, policies, priorities and capabilities.

Furthermore, in order to preserve clear lines of responsibility and accountability, the CBJ advised banks to separate the role of Chairman of the Board and the role of General Manager or Chief Executive Officer and the Chairman should be a non-executive Board member and not have any day-to-day operating responsibilities. The analysis reveals that many large banks in Jordan had no separation between the Chairman of the Board and the General Manager or even one person has the two positions (Arab Bank, 2009). The Central Bank of Jordan develops its vision to have an efficient and competitive banking system in Jordan that meets international standards of best practices in risk management and corporate governance, complies with applicable laws and regulations and satisfies the credit needs of the domestic economy thereby supporting the economic development of the Kingdom. The Central Bank of Jordan believes that Bank Directors have an integral role in the Bank success, a safe and sound banking system requires responsible and knowledgeable bank management with good corporate governance and risk management systems to support sound and prudent lending and other bank policies. Therefore, the Central Bank of Jordan in 2004 issued *Bank Directors Handbook of Corporate Governance* which has been developed with the objective of enhancing the corporate governance of banks in the Kingdom. The *Handbook* has the following five main sections, each of which addresses a broad area of corporate governance and bank director responsibilities and duties:

- (1) Introduction and Background defines corporate governance, discusses why it is important for a bank's safe and sound operation and outlines best practices.
- (2) Director Standards, values, and efficiency outlines qualities of bank directors and how boards can effectively and efficiently fulfill their responsibilities to shareholders, depositors and other stakeholders.
- (3) Management Selection and Oversight describes one of the Board's most important functions and how it interacts with operating management.
- (4) Planning and policies describe the Board's responsibilities to approve and monitor implementation of plans and policies.
- (5) Internal Control and Audit discusses how the internal control system, internal audit and independent external audit interact and complement bank supervision.

In the analysis, this Handbook does not substitute prevailing Banking Law or regulations issued by the Central Bank of Jordan. It is meant to provide only guidance and bank directors are encouraged to review their responsibilities and conduct on an ongoing basis and seek counsel as necessary. Also, to ensure that board members are qualified for their positions, every director must be "fit and proper" to serve the interest of the bank and other stakeholders. The phrase that was put by the CBJ is fit and proper, as qualifications of the general director in today's business may not fit enough for this position, it is a loose phrase. Further to issuing the Bank Director's Handbook of Corporate Governance in 2004, the Central Bank of Jordan is continuing in its efforts to enhance corporate governance in the Jordanian banking system by preparing, in 2007, the Corporate Governance Code which is intended to promote international best practice in the corporate governance of Jordanian banks.

The Code draws upon international best practice, in particular the OECD principles of Corporate Governance and the guidance issued by the Basle Committee on Banking Supervision in their publication (1999): *Enhancing Corporate Governance for banking Organizations*. By using this code as a model, the Central Bank of Jordan is expected that each Jordanian bank will produce its own code according to its particular needs and principles and incorporating the minimum standards of the central bank of Jordan, and will proceed to implement its own code by 31/12/2007. In order for any bank to obtain the full benefit of improving corporate governance practices, we found that each bank carefully considers the meaning of the individual provisions of the Corporate Governance Code, comes to its own understanding of how to apply them, and then publishes its own code in its annual report and on its website. Also, each bank confirms in its annual report the extent of its compliance with its code and explains why any provisions have not been complied within any particular year. Furthermore, each bank adopting a code asked by the Central Bank of Jordan begin by setting out in its own words its institutional view of corporate governance, its meaning and its importance, and to clarify this issue further, a sample text is given by the Central Bank of Jordan to be followed by each bank, although it is expected that each bank will wish to draft its own introduction.

Our analysis found that the Central Bank of Jordan, in line with a bank's continued evolution, asked each bank to keep this code under review and be developed and amended as required from time to time to meet the changing needs and expectations of the bank and the marketplace.

## **6. Conclusion**

Corporate governance continues to gain attention and importance from parties concerned in the Jordan banking sector, due to many reasons such as the BCBS requirements, the financial crisis in some financial firms, as well as for the country as a whole. Therefore, the government of Jordan involves itself in the banking activities by imposing restrictions, issuing specific regulations related to financial practices, and restructuring the banking system as a whole. This involvement may create unstable ground for future long-term planning for banks. But in reality, the banking sector in Jordan acts in accordance with a request from the CBJ based on the BCBS requirements through enhancing the corporate governance procedures conducted by the banks. The CBJ provides only guidance to enhance the corporate governance of banks in the Kingdom and bank directors are encouraged to review their responsibilities and conduct on an ongoing basis and seek counsel when necessary.

The CBJ's vision is to have an efficient and competitive banking system in Jordan that meets the international standards of best practices in corporate governance, complies with applicable laws and regulations and satisfies the credit needs of the domestic economy thereby supporting the economic development of the Kingdom. Therefore, we found that the CBJ and other Jordanian banks have commitment to corporate governance in the following issues:

1. Each bank has compiled the corporate governance code, which has been approved by the Bank's Board and is published. An up-to-date version of the Code is available to the public on request and on the Bank's website.
2. Each bank has formed a corporate governance committee of the Board, comprising the Chairman of the Board and two of the non-executive Directors, to direct the preparation, updating, and implementation of the Code.
3. Each bank on an annual basis publicly reports its compliance with the Code, where necessary detailing how each provision of the Code has been implemented and, where relevant, where and why the Bank's executive management has adopted procedures that are different from those recommended by the Code.

As a concluding remark, the banking sector is the most regulated sector among all the sectors in Jordan, but the financial crisis happened and got out of control. The CBJ needs to advise banks not to take risks and to design an effective banking regulation. Therefore, in order to design an effective banking regulation it is necessary for the CBJ to have a clear idea of what are the benefits and what are the costs of regulation, and a good example of what happens if there is not a clear idea of the benefits and costs of regulation is the Basel agreements. It is not clear what problems the agreements are trying to solve from the documents, they did not prevent the financial crisis and they seem to have had very little effect in reducing its severity.

The research did not take into consideration the link between banks' commitment in CG and their performance. Therefore, this issue needs more elaboration.

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**Table (1)** Corporate Governance Recommendations in different Countries

Items / Country	OECD	Singapore	UK	USA	Jordan
1. Disclosure of compliance	Yes	Yes	Yes	n/c	Yes
2. Board responsible for	n/c	Shareholders	Shareholders	Shareholders	Shareholders
3. Separation of Chairman & CEO	Encouraged	n/c	Yes	No firm recommendation	Encouraged
4. Non-executive directors	Majority	n/c	Yes	Majority	At least a third
5. Audit committee	Yes majority NED	Yes majority NED	Yes majority NED	Yes only NED	Yes majority NED
6. Governance committee	n/c	n/c	n/c	Yes only NED	Yes majority NED
7. Nomination committee	Yes only NED	n/c	Yes majority NED	Yes only NED	Yes majority NED
8. Remuneration committee	Yes only NED	n/c	Yes only NED	Yes only NED	Yes majority NED
9. Director re-election	n/c	3 Years (CEO 5 years)	3 years	n/c	4 years
10. One share, one vote	n/c	n/c	n/c	n/c	Yes
11. Shareholder approval of remuneration	n/c	n/c	Only long-term incentive schemes	n/c	Yes

### Abbreviations:

*NED* Non-executive directors (or independent directors) not involved in the day-to-day running of the company; *n/c* not covered; *OECD* Organization for Economic Cooperation and Development.

### ملخص الدراسة باللغة العربية

تحاول هذه الدراسة تفهم جهود البنوك الأردنية لتعزيز أحوالها المؤسسية لدى الجهاز المصرفي الأردني وكيفية تأثيرها بمبادئ أحوالها المؤسسية الصادرة عن منظمة التعاون الاقتصادي والتنمية وكذلك الإرشادات الصادرة عن لجنة بازل حول تعزيز أحوالها المؤسسية في المؤسسات المصرفية.

تظهر الدراسة بأن البنوك الأردنية وعلى رأسها البنك المركزي الأردني تولي اهتماماً بالغاً لموضوع أحوالها المؤسسية وتعزيزها في الجهاز المصرفي الأردني، حيث أصدر البنك المركزي الأردني كتيب إرشادات التحكم المؤسسي لأعضاء مجالس إدارة البنوك في الأردن والذي تم تطويره بهدف تحسين وتوفير معيار أفضل الممارسات الدولية في مجال التحكم المؤسسي وذلك استناداً لما جاء في مبادئ أحوالها المؤسسية الصادرة عن منظمة التعاون الاقتصادي والتنمية والإرشادات الصادرة عن لجنة بازل.

ولتعزيز أحوالها المؤسسية لدى الجهاز المصرفي الأردني، قام البنك المركزي الأردني أيضاً بإصدار دليل أحوالها المؤسسية للبنوك الأردنية وطالب البنوك العاملة في المملكة الإحاطة بكافة بنود الدليل وكيفية تطبيقها على أرض الواقع وكذلك أعطى لكل بنك الحق بمراجعة هذا الدليل وتطويره وتعديله من وقت لآخر وكلما اقتضت الحاجة وذلك بهدف مواكبة التغيرات في احتياجات وتوقعات البنك ومعطيات السوق المصرفي.