CORPORATE GOVERNANCE AND ACCOUNTING CONSERVATISM IN ISLAMIC BANKS

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رؤية بنك الكويت المركزي والبنوك الكويتية لتطوير الشباب الكويتي

The Winning Research Paper for the 2018
"Kuwaiti Economic Researcher Prize"

البحث الفائز "بجائزة الباحث الاقتصادي الكويتي" لعام 2018

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حوكمة الشركات والتحفظ المحاسبي في البنوك الإسلامية

تهدف هذه الدراسة الى التعرف على ما إذا كانت البنوك الإسلامية أكثر تحفظا في الممارسات المحاسبية من البنوك التقليدية أثناء إعداد التقارير المالية ، فضلا عن معرفة كيفية تأثير الخصائص الفريدة لنظام الحوكمة في البنوك الإسلامية على سلوكيات التحفظ المحاسبي. تم استخدام عينة كبيرة من البنوك الإسلامية وأخرى مطابقة من البنوك التقليدية وفقا لإجمالي الأصول والموقع الجغرافي في (15) بلدًا.

أظهرت نتائج الدراسة على أن البنوك الإسلامية تتبع منهج التحفظ المحاسبي في إعداد التقارير المالية على نحو أوسع من البنوك حيث تزيد نسبة ، C-score التقليدية ، وذلك وفقًا لمقاييس تجنب الخسارة ، ومخصصات خسارة القروض غير العادية ، و احتمالية تحفظ البنوك الإسلامية في الممارسات المحاسبية على أكثر من 95 % مقارنة بنظيراتها من البنوك التقليدية، وذلك اعتماداً على مواصفات نموذجية مختلفة. بالإضافة إلى ذلك ، فإن العديد من خصائص أعضاء مجالس الإدارة ، مثل العدد والاستقلالية والسمعة ومدة العضوية والتنوع هي من المحددات المهمة للتحفظ المحاسبي في البنوك الإسلامية. كذلك فإن بعض سمات أعضاء مجلس الإدارة تزيد من الدور الرقابي لعضو مجلس الإدارة ، والذي من شأنه المساهمة في زيادة درجة التحفظ في الممارسات المحاسبية والحد من السلوك غير الأخلاقي.

ABSTRACT

We examine whether Islamic banks are more likely to be conservative in their financial reporting than conventional banks, as well as how Islamic banks' unique corporate governance system affects accounting conservatism behaviors. Using a large sample of Islamic banks and their matched non-Islamic banks; based on total assets and geographic location, in 15 countries, we find Islamic banks are more likely to deploy accounting conservatism as measured by loss avoidance, abnormal loan loss provisions, and C-score, respectively. Islamic banks are about 95% more likely to be more conservative in accounting practices than their counterparts, depending on different model specifications. In addition, we report several board characteristics, such as size, independence, reputation, tenure, and diversity, are important determinants of accounting conservatism in Islamic banks. This relationship indicates certain board traits lead to greater monitoring roles, consequently reducing unethical behavior and increasing the degree of conservatism in accounting practices.

KEYWORDS
accounting conservatism, ethics, Islamic Bank, Shari'ah

JEL CLASSIFICATION
G15, G21, M41

1.0 INTRODUCTION

Following the high-profile downfalls of corporate managers due to ethics violations (e.g., Enron, Adelphia, and WorldCom), and the passage of the SOX Act in 2002,[1] researchers are paying more attention to corporate governance.[2] In particular, regulators, practitioners, and academics have pressed for more sophisticated accounting practices, among which is conservatism. Conservative accounting practices may improve the veracity of financial statements and, therefore, regain public trust and confidence in the financial reporting system. Accounting conservatism is defined as "accounting policies or tendencies that result in the downward bias of accounting net asset value relative to economic net asset value (Ruch & Taylor, 2015)."

Executive managers can implement two types of accounting onservatism: unconditional or conditional (Beaver & Ryan, 2005). Unlike unconditional conservatism, conditional conservatism depends on economic news events. Conditional conservatism refers to timely recognition of negative news to positive news of economic events in accounting earnings (e.g., goodwill impairment, asymmetry in gain/loss contingencies, long-lived asset impairment, and inventory recorded at the lower of cost or market). Unconditional conservatism occurs through the consistency of recording low book values of net assets relative to their fair values (e.g., immediate expenses R&D, accelerated depreciation methods, allowance for bad debt expenses, and warranty allowance) (Ruch & Taylor, 2015).

Existing literature focuses on commercial banks (hereafter, CBs) and their accounting conservatism. However, this article compares accounting conservatism between Islamic banks (hereafter, IBs) and CBs, and it analyzes IBs' sophistication in accounting practices due to their distinct nature. IBs are interest-free banking and their banking transactions are based on different financing modes of sharing the basis of payment obligations with revenue accrual, removing the major sources of instability in a free market. Thus far, their distinct nature dictates they will need to follow a strict accounting conservatism (Quttainah, 2012).

To better understand religion's effects on accounting behaviors, we need to analyze environments that could influence accounting decisions. Culture does affect accounting practices (Askary, Pounder, & Yazdifar, 2008). Soll (2014) notes "financial accountability" gets even better when accounting is viewed as part of culture values not just part of a business transaction. Historically, religion has a significant role in shaping and affecting cultural values, such as fairness and honesty (Lewis, 2001). Lewis (2001) argues if culture indeed has such an effect, then religion that influences cultural values does affect accounting practices. Mutch (2016) explores the impact of religion on Scottish accounting texts in the eighteenth century using a sample of five administrative units of the Church of Scotland. He notes accounting practices are broadly shaped by the religious context of the Church of Scotland.

Thus, Shari'ah affects the principal-agent relationship based on converting cash into assets that may be worth more or less in the future, which is of prime importance and is the source of profit or loss. Hence, most IBs are rich in cash due to strict adherence to rules regarding what products and services banks offer (Quttainah, 2012). Such strict adherence is also reflected in accounting behavior in accounting behavior (Quttainah, Song, & Wu, 2013). Hence, the intensity of adherence to Shari'ah, which is the cornerstone of conducting business and financial deals in IBs, reflects differences in accounting conservatism between IBs and CBs.

As Shari'ah is one of the most important determinants of internal governance for IBs, this article asks two questions. First, are IBs more conservative in their accounting reporting compared to CBs? Second, do board characteristics such as size, reputation, tenure, and diversity enhance accounting conservatism practices in IBs?

Following prior studies such as Francis, Hasan, and Wu (2013), Leventis, Dimitropoulos, and Owusu-Ansah (2013), Talebnia and Javanmard (2011), García Lara, García Osma, and Penalva (2009), and LaFond and Watts (2008), we use three proxies to measure accounting conservatism in the banking industry: loss avoidance, abnormal loan loss provisions (LLPs), and C-score. We control for major bank characteristics, size, growth

tunities, the change in cash flow, and allowance for loan losses, all of which may affect accounting conservatism. Additionally, we control for potential risk differences between IBs and CBs (Quttainah & Almutairi, 2017). CBs and IBs hold different kinds of loans and other asset portfolio structures; thus, they could have different incentives to increase/reduce certain accounting behaviors. We also control for country effects and year effects that are likely to affect accounting conservatism.

Based on a sample of 3,772 bank-year observations from 82 IBs and 82 CBs in 15 countries between 1993 and 2015, we find IBs are more conservative in their accounting practices compared to CBs. In fact, we show IBs are about 95% more likely to be more conservative in accounting practices than their counterparts, depending on different model specifications. This result holds after adjusting for country and year effects and is robust to the inclusion of various control variables (microlevel and macrolevel). In addition, the average loss avoidance for IBs is 26% compared to 30% for CBs. The abnormal loss loan provision for IBs is 0.1% compared to 0.3% for CBs. Nevertheless, the mean C-score for IBs is 9%, and the mean C-score for CBs is 5%. These results indicate IBs have greater ethical standards, which leads to higher accounting conservatism. They also indicate Shari'ah effectively constrains unethical behaviors among IB managers.

We also report several board characteristics such as size, independence, reputation, tenure, and diversity are important determinants of accounting conservatism in IBs. For example, the relationship between loss avoidance and abnormal LLPs (C-score), and board characteristics is negative (positive). This relationship indicates certain board traits lead to greater monitoring roles, consequently reducing unethical behavior and increasing the degree of conservatism in accounting practices.

The remainder of the article is organized as follows. Section 2 reviews the extant literature and develops the research hypotheses. Section 3 describes data collection, sample selection procedures, and empirical models. Empirical main and robustness results are presented in Section 4. Summary and major conclusions are presented in Section 5.

2 | LITERATURE AND HYPOTHESES DEVELOPMENT

2.1 | Features of banks

The banking industry is the most regulated industry in the world, and it is unlike other industries. For instance, its governance structures have numerous unique features that could magnify agency problems. Banks are less visible than nonfinancial firms, which also aggravates agency problems (Caprio Jr. & Levine, 2002) because greater information asymmetry exists among investors.

Adverse selection happens in banks when deposit insurance programs intended to protect small depositors' interests actually lead to moral hazards. These programs may incentivize managers to engage in unethical practices or risky projects. Unlike creditors who have expertise and skills to evaluate bank products and services, and therefore are better at monitoring bank managers, small depositors lack such advantages. In fact, deposit insurance schemes may motivate managers to rely less on borrowing. Thus, managers may be more likely to monitor insured depositors than uninsured creditors, which could expose their banks to litigation risks. Creditors can sue bank directors for mismanagement and misconduct (Petrin, 2012).

In addition, banks are highly leveraged with a significant portion of their debts consisting of cash deposits. On the other side, banks' illiquid assets may fail to meet claims of creditors, creating substantial risks to debt holders (Heremans, 2007). Furthermore, the reputation and credibility of the banking industry are far more critical than in other industries. This is because banks provide a large number of intangible services and run financial operations primarily based on trust (Stansfield, 2006; Trotta & Cavallaro, 2012). Like other businesses, banks are subject to shocks due to several risks (e.g., credit, bankruptcy, litigation, fraud, and market). However, if one or more banks are exposed to any of these risks, the entire

banking industry may be affected, and the financial market at large could be affected as well.[3] If this effect becomes contagious, the public trust and confidence in the banking industry may evaporate.

On the other hand, according to the International Association of Islamic Banks (IAIBs), utility in IBs is measured by converting cash into assets. Even though the time value of money is being forfeited, the concept of generating rent on capital is lost, and strict religious guidance prohibits usury (interest) and gharar (excessive uncertainty, deception, or risk-taking). For example, interest on credits and cash advances that creates a renter class in society is forbidden (Quttainah, 2012). Despite the highly regulated industry IBs operate in, another important regulatory aspect is the religious internal governance mechanisms that allow banks to call themselves Shari'ah compliant.

Features and concepts by which IBs govern their transactions are under the auspices of contracts, which are interest-free. Interest payments are defined as the return on transactions involving the exchange of similar assets (e.g., money for money with time-based premiums or reductions). Note that as unusual as these concepts seem in a traditional context, many of the functional benefits of commercial banking products can be provided in Shari'ah-compliant transactions. However, a handful of CBs transactions, such as futures, derivatives, and other transactions that involve risk-taking and gambling are prohibited. Therefore, IBs have many liquid assets, especially cash (Quttainah, 2012).

2.2 | Accounting conservatism

Traditionally, accountants express conservatism by following the rule "anticipate all losses but report no gains." Accounting conservatism requires accountants to verify all transactions carefully before legally reporting any gains, as they are required to recognize all possible losses. In situations where accountants have to choose between two alternatives in financial reporting, accounting conservatism provides rules and guidelines, which keeps them objective and provides fair presentation of the company's financial status.

Prior literature indicates accounting conservatism influences disclosure quality (Ball, Robin, & Wu, 2003; Beekes, Pope, & Young, 2004; Fan & Wong, 2002). Conservatism exists in financial disclosures (Beaver & Ryan, 2000; Givoly & Hayn, 2000) as a result of regulation, taxation, litigation, or contracting (Basu, 1997; Watts, 2003). Boards of directors can adopt accounting conservatism to address agency problems (A. S. Ahmed & Duellman, 2007; Watts, 2003). Accounting conservatism limits managerial opportunism (e.g., reduces excess payments to managers at the expense of shareholders), reduces litigation risk costs, increases the efficiency of debt and other covenants, and maintains surveillance over contracts (Ball & Shivakumar, 2005). Evidence in Francis et al. (2013) also suggests accounting conservatism mitigates information risk and agency problems. Zhang (2008) shows lenders impose lower interest rates on conservative borrowers. DeFond, Lim, and Zang (2012) report conservative audit clients are less likely to restate accounting numbers. The literature also shows accounting conservatism affects investment efficiency (Chen, Hu, & Lin, 2013; Cho & Choi, 2016; García Lara, García Osma, & Penalva, 2016).[4]

Conversely, financial market regulators, financial reporting standards-setters, and academics heavily criticize conservatism in accounting practices, arguing it may introduce bias in financial reporting and hence distort financial statements (Gigler, Kanodia, Sapra, & Venugopalan, 2009; Jackson & Liu, 2010 and Watts, 2002). Accounting conservatism tends to understate net assets, and losses, compared to gains, on the income statement are immediately recognized. Therefore, a firm's debt-to-asset ratio (net income) is systematically overstated (understated) compared to its true economic leverage (net income) value. Consequently, the firm's financial position is distorted, thereby reducing its ability to raise capital. In addition, amid the criticism of conservative accounting practices is that accounting conservatism is arbitrary (i.e., managers can have great discretionary power over financial reporting) and has an inconsistent impact on reported income (Chatfield, 1996).

2.3 | IBs and accounting conservatism

Accounting conservatism should be more pronounced in the banking industry compared to other industries because of its high complexity, great information risk, contracting distinctiveness, and intense egulations and rules (Hsu, Novoselov, & Wang, 2017). In Watts (2003), regulators support firms that have conservative accounting and financial practices; doing so helps avoid public criticisms in case these firms go bankrupt. Also, central banks favor banks that establish big LLPs, a sign of accounting conservatism, when economic conditions improve (Turner et al., 2010).

IBs are more likely to exercise conservative accounting policies than CBs for several reasons. First, IBs conduct their business according to the Shari'ah law, which stresses social justice and fair distribution of wealth through an Islamic levy known as zakat.[5] Besides corporate taxes, IBs are required to pay zakat. This additional obligation strongly incentivizes IBs to be more conservative in their accounting practices compared to CBs (AlAbbad, 2016).

Second, religious people in general tend to be more risk-averse (Miller, 2000) and managers of religious-influenced entities are thus less likely to be sued (McGuire, Omer, & Sharp, 2011). Thus, arguably this may indicate religious people and religious-influenced entities are more likely to be conservative in their decision-making.

Third, agency problems are more pronounced in IBs as opposed to CBs, which motivates IBs to follow more conservative accounting policies. For example, profit-sharing investment accounts represent a major source of funds in IBs.[6] Holders deposit their funds on a profitsharing and loss-bearing basis, but they have no power to monitor their funds' performance (Al-Sadah, 2007). Their status provides no rights to monitor management behavior or influence management decisions. In addition, they neither nominate board directors nor hire external auditors. Instead, they rely on shareholders to monitor management behavior and performance. However, equity holders absorb losses on the asset-backed securities, raising concerns about transparency and disclosure (Mejía, Aljabrin, Awad,

Norat, & Song, 2014). Moreover, transparency in corporate governance disclosures still need to be improved significantly (Abdullah, Percy, & Stewart, 2014). Less transparency causes information asymmetry between banks and their shareholders, creating greater concerns over credibility and confidence. All these agency problems put pressure on IBs to be more conservative in their accounting and reporting practices.

Fourth, regulators still have major concerns about whether the features of the Islamic banking system have an impact on the development of this industry. Although several countries have improved their regulatory and supervisory Islamic banking frameworks, more progress is still required (López-Mejía, Aljabrin, Awad, Norat, & Song, 2014; Song & Oosthuizem, 2014).

Fifth, managers with less ethical commitment may exploit the flexibility in accounting standards to inflate reported earnings (Choi & Pae, 2011). IBs' ethical environments, however, promote honesty in financial reporting and discourage unethical business behavior. Strict adherence to Shari'ah should thus counter any immoral incentives and reduce inefficiency arising from moral hazards and information asymmetry (Hasan, 2012).[7] In fact, Quttainah and Almutairi (2017) show IBs engage in fewer unethical accounting practices (measured by accruals and abnormal LLPs) than CBs do. The ethical element potentially incentivizes firms to follow more conservative accounting practices, according to Choi and Pae (2011), who find firms with greater commitments to business ethics report earnings more conservatively.

Last, IBs have an additional layer of corporate governance, Shari'ah supervisory boards (SSB), which strictly ensure all IBs' accounting and financial transactions adhere to Islamic principles.[8] There are different Islamic schools of thought and each school has a different interpretation for the Shari'ah and Sunna (Quttainah, 2012). Consequently, since members of the SSB come from different Islamic schools of thought, these differences may exacerbate disagreements regarding Shari'ahcompliant transactions and interpretations of Shari'ah principles. This could

largely reflect variations in financial reporting, auditing, and accounting treatments (Mejía et al., 2014), creating more pressure on IBs to adopt prudential accounting practices. The conservative and ethical inclinations of IBs can thus mitigate fraudulent financial reporting and, therefore, may have important accounting and economic implications. The following hypothesis is, therefore. stated in an alternative form:

Hypothesis 1 Ceteris paribus, IBs have more conservative accounting practices than CBs.

2.3.1 | Board size and accounting conservatism

Board size affects the level of consensus, shared knowledge, and expertise among directors. In turn, board size is critical to board effectiveness and firm performance improvement, especially when networks and access to economic resources are important (Kiel & Nicholson, 2003). Some companies require larger boards for effective monitoring (Adams & Mehran, 2003). In complex companies (e.g., banks), for example, the benefits of larger boards outweigh the costs (Coles, Daniel, & Naveen, 2008). Larger boards maintain better networks and have more expertise (Dalton, Daily, Johnson, & Ellstrand, 1999).

Empirical evidence also suggests bankruptcy is less likely in firms with larger boards (Chaganti, Mahajan, & Sharma, 1985). Similarly, evidence shows firms with larger boards are less risky (Birnbaum, 1984), have less information asymmetry (Chen & Jaggi, 2000), are more visible in their communities (Provan, 1980), enjoy lower cost of debt (Anderson, Mansi, & Reeb, 2004), and are better in allocating resources (Goodstein, Gautam, & Boeker, 1994; Pearce & Zahra, 1992). In Pfeffer and Salancik (2003), firms with larger boards perform better because they budget, raise external capital, and manage leverage more efficiently. Kiel and Nicholson (2003) also show firm performance increases with board size.

Alternatively, a large board can be less effective at monitoring management, because having more directors means more complicated coordination and communication, as well as delays in decision-making processes (Eisenberg, Sundgren, & Wells, 1998; Forbes & Milliken, 1999; Gladstein, 1984; Judge & Zenithal, 1992; Shaw, 1981; Yermack, 1996). Small boards are also more effective than large ones because directors are less likely to disagree (Lange et al., 1978) and more likely to encourage genuine interaction and debate (Firstenberg & Malkiel, 1994).

Studies on the relationship between board size and accounting conservatism are limited. Boussaid, Hamza, and Sougne (2015) and

K. Ahmed and Henry (2012) do find a negative association between board size and conditional conservatism. Based on a sample of 3,852 firm-year observations of nonfinancial Malaysian public firms over 2001-2012, Abdul-Manaf, Amran, and Zainol-Abidin (2014) show firms with smaller boards are more conservative. A. S. Ahmed and Duellman (2007), however, show no link between conditional conservatism and board size. Therefore, because prior studies provide mixed evidence on the effect of board size on financial reporting quality and accounting conservatism, we predict a relationship between accounting conservatism and board size but state no direction. Put formally:

Hypothesis 2 Ceteris paribus, in IBs, accounting conservatism is related to board size.

2.4 | Board composition and accounting conservatism

Incentives and the ability to monitor and control management vary among directors. In addition, the characteristics of directors affect board efficiency. Empirical evidence indicates boards with independent outside directors are more effective. Weisback (1988) reports CEO turnover following poor financial performance is more likely to occur in firms when the board of directors are dominated by independent directors. Evidence also shows firms with higher proportions of independent outside directors are less likely to manage earnings (Dechow, Sloan, & Sweeny, 1996) and disclose more negative information (Abrahamson & Park, 1994). Daily and Delton (1994) indicate financially distressed firms with more independent outside directors are more likely to avoid bankruptcy than financially distressed firms with few independent outside directors. In Kiel and Nicholson (2003), firm performance rises when more independent directors are on the board.

Nonetheless, a sample of 1,271 UK listed companies between 1993 and 1996 shows independent outside directors curb income-increasing earnings management but have no effect on income-decreasing manipulations. Klein (2002) documents a negative association between the presence of independent outside directors and discretionary accruals for a sample of 692 U.S. public firms in the S&P 500 index during 1992–1993. In addition, Xie, Davidson, and DaDalt (2003) show earnings management is less likely to occur in firms that have higher proportions of independent directors. That study uses a sample of 290 public firms in the S&P 500 index in 1992, 1994, and 1996. Park and Shin (2004) report similar results using 539 Canadian listed companies for the period 1991–1997.

These findings show independent directors improve monitoring and thus may improve earnings quality. This implies independent outside directors are more conservative about governance, which should lead to greater accounting conservatism. Therefore, in the presence of more independent outside directors, management is less likely to compromise the quality of financial disclosures and more likely to require conservative practices.

Prior studies show a link between board independence and accounting conservatism. For example, based on a sample of 41 UK firms, Beekes et al. (2004) show accounting conservatism increases when the number of independent directors increases. A. S. Ahmed and Duellman (2007) use a sample of 306 firms in the S&P 500 firms over fiscal years 1999–2001 and report a positive relation between the percentage of outside directors and conservatism. Kankaanpaa (2009) examines the relation between board independence and earnings quality, measured by earnings timeliness and earnings conservatism, for a sample of Finnish publicly listed companies. His findings indicate the proportion of independent directors has a positive effect on the timeliness of bad news reflected in earnings. Based on these findings, we offer the following hypothesis:

Hypothesis 3 Ceteris paribus, in IBs, accounting conservatism is positively related to the proportion of independent outside directors.

2.5 | Board reputation and accounting conservatism

Independent outside directors have heterogeneous incentives to monitor and control management. However, their oversight roles may vary according to the value of their reputations. Specifically, research shows the market for managerial labor motivates independent outside directors to develop reputations as decision experts by monitoring and controlling management (Fama & Jensen, 1983). Shivdasani (1993) reports the reputations of independent outside directors, proxied by multiple directorship, increase the effectiveness of board monitoring. In Masulis and Mobbs (2014), directors who serve on more prestigious directorships are less likely to resign when firm performance is poor. They also show a positive relationship between firm performance and the reputations of independent outside directors.

In a different working article, Masulis and Mobbs (2012) show firms with highly reputable directors are less likely to be delisted or sued, violate debt covenants, manage earnings, restate earnings, backdate options, and reduce cash dividend rates. Also, Masulis and Mobbs (2011) and Mobbs (2013) report boards with directors who have directorships in other firms make better decisions and monitor CEO behavior more closely. Furthermore, Kaplan and Reishus (1990) report firms are less likely to cut dividends if their boards consist of directors with multiple directorships.

Prior studies also show director reputation is largely influenced by specific key board decisions. For instance, directors of firms that restate earnings or commit fraud have fewer future directorships (Srinivasan, 2005). In addition, Kaplan and Reishus (1990) show directors in firms that cut dividends are nominated for fewer directorships in the future. Therefore, it is evident that the reputations of independent outside directors decline if they exert weak governance and are sloppy monitors. Accordingly, reputable directors are perceived as more effective monitors. In addition, the personal costs of reputation and career impairment may make independent directors more cautious,encouraging them to adopt conservative accounting practices.

This leads to the following hypothesis:

Hypothesis 4 Ceteris paribus, in IBs, accounting conservatism is positively related to the reputation of independent outside directors.

2.6 | Board tenure and accounting conservatism

Prior studies examine the association between a director's tenure and his or her ability to monitor management (Beasley, 1996; Berberich & Niu, 2011; Bonini, Deng, Ferrari, & John, 2015; Rutherford & Buchholtz, 2007; Schnake, Fredenberger, & Williams, 2005; Sharma, 2011; Vafeas, 2003). Empirical evidence indicates longer-tenured outside directors are more effective monitors and hence are better able to prevent fraud (Beasley, 1996) and 10-K violations (Schnake et al., 2005). Sharma (2011) shows a positive association between the tenure of independent directors and the likelihood of dividend payouts. Bonini et al. (2015) note longer-tenured independent directors are better monitors due to their ability to gather, maintain, and share valuable information about their firms. Their evidence also shows such firms are more profitable and have higher market values. In turn, independent directors with longer tenures are associated with greater business stability, tend to have more knowledge about the company, maintain more governance experience, and contribute more to boardroom discussions.

On the other hand, longer tenures can adversely affect firm performance.

For instance, increased familiarity between directors and management can jeopardize independence (Fracassi & Tate, 2012) and, therefore, weaken monitoring. Vafeas (2003) shows outside directors with long tenures are less effective monitors. Directors also become less vigilant as they get closer to retirement; directors in their early years of board service tend to be better monitors, as their ability will be assessed and rewarded by an efficient labor market (Huang, 2013). In addition, Huang (2013) reports a negative link between the tenure of outside directors and the quality of financial reporting. He finds newer outside directors make better acquisition decisions, engage in less earnings management, are more likely to replace bad managers (i.e., CEOs), and support more conservative accounting practices. Given the two competing views on how tenure affects monitoring efficiency, we expect a relationship between accounting conservatism and director tenure but with no direction. Therefore, we offer the following hypothesis:

Hypothesis 5 Ceteris paribus, in IBs, accounting conservatism is related to the tenure of independent directors.

2.7 | Board diversity and accounting conservatism

A diverse board consists of directors with unique traits (e.g., gender, ethnicity, age, and education) that may affect firm value. For example, board diversity may boost creativity and innovation, produce more effective problem-solving (e.g., Watson, Kumar, & Michaelsen, 1993; Wiersema & Bantel, 1992), enhance access to different resources and global connections, signal the firm's commitment against minority discrimination, cultivate an image of corporate social responsibility (Ferrrira, 2010), foster leadership efficiency, and contribute to a better understanding of the marketplace (Robinson & Dechant, 1997).

Furthermore, although the role of the board directors is vital to countering managerial opportunistic behavior (Donaldson & Davis, 1991), boards can be more effective if they are diverse. Agency theory argues board diversity increases board independence, leading to more activism and better monitoring of management (Carter, D'Souza, Simkins, & Simpson, 2010). In particular, evidence shows female directors have a positive effect on firm value (Campbell & Minguez Vera, 2010; Campbell & Minguez-Vera, 2008). In Lückerath-Rovers (2010), Dutch firms with female directors outperform their counterparts. Evidence also shows the presence of female directors reduces discretionary accruals, which suggests more accounting conservatism (Peni & Vähämaa, 2010; Srinidhi, Ferdinand, & Tsui, 2011).

However, few research articles show a positive link between board gender diversity and accounting conservatism. Boussaid et al. (2015), for instance, show greater gender diversity promotes more conservative accounting practices. In Zhou (2012), firms adopt more conservative accounting practices when they transition from all-male boards to boards with at least one female director.

Other studies also show a positive relationship between other aspects of board diversity and firm performance (e.g., Marimuthu, 2008; Marimuthu & Koladaisamy, 2009a; Nishii, Gotte, & Raver, 2007). Kim and Lim (2010) examine the association between the diversity of independent outside directors and the value of Korean firms. They find diversity in age and academic majors among independent outside directors has a positive impact on firm valuation. They also show the proportion of outside independent directors with government experience positively influences valuation.

Alternatively, there could be some downsides to board diversity. In Ferrrira (2010), for example, demographically dissimilar directors have different values and views, which could reduce interaction and communication among directors. In addition, such directors could have limited interpersonal attraction and fragile board cohesiveness. Another downside of board diversity could be the possibility of nominating directors for their demographic characteristics rather than for their experience and qualifications. Some prior literature does show board diversity (i.e., gender) has a negative impact on firm value (e.g., Palmberg, Eklund, & Wiberg, 2009). In addition, Sultana and Van der Zaha (2011) report Australian firms with female directors practice less accounting conservatism. Other research, however, shows no association between board diversity (e.g., ethnicity) and firm value (e.g., Marimuthu & Koladaisamy, 2009b; Marimuthu & Koladaisamy, 2009c).

Empirical evidence on how board diversity affects accounting conservatism is inconclusive and scant, which makes it difficult to predict whether an association between board diversity and accounting conservatism exists. However, the aforementioned studies should provide a basis for our empirical tests. This leads to the following hypothesis:

Hypothesis 6 Ceteris paribus, in IBs, accounting conservatism is not related to board diversity.

3 | DATA AND METHODOLOGY

3.1 | Data collection procedure

Our sample consists of listed IBs available in the BankScope database between 1993 and 2015. We construct a balanced panel sample and eliminate IBs with missing accounting data in the BankScope database. In addition, we exclude development and investment IBs from the sampling frame. These procedures result in 100 IBs with full accounting data. Furthermore, we delete 18 IBs that do not have the same accounting years and have incomplete governance scores in the Risk Metrics database. This procedure results in a balanced sample of 82 IBs with full 22-year bank information, yielding 1,886 firm-year observations.

IBs with CBs are matched based on total assets and geographic location. Our matched sample consists of 82 CBs from 15 countries. Data on regular board characteristics, number of directors, IBs and CBs specializations, assets, liabilities, earnings, expenses, credit ratings, country credit ratings, and risk-rating information are manually retrieved from the BankScope database and supplement it with information from several country-level and bank-level websites. The outcome of both samples consists of 3,772 observations for 164 banks. Table 1 depicts the frequency distribution of IBs. We find Bahrain has the highest frequency (22%) and Indonesia has the lowest frequency (0.94%).

TABLE 1 Frequency of Islamic banks (IBs) across countries

COUNTRY	FREQ.	PERCENTAGE
Bahrain	828.33	21.96
Bangladesh	125.61	3.33
Egypt	138.06	3.66
Indonesia	35.46	0.94
Iran	276.11	7.32
Jordan	77.33	2.05
Kingdom of Saudi Arabia	138.06	3.66
Kuwait	276.11	7.32
Lebanon	92.04	2.44
Malaysia	322.13	8.54
Pakistan	414.17	10.98
Qatar	173.51	4.60
Sudan	368.15	9.76
Turkey	184.07	4.88
UAE	322.13	8.54
Total	**3,772**	**100.00**

The highest frequency (22%) and Indonesia has the lowest frequency(0.94%).

3.2 | Measuring accounting conservatism

Because accounting conservatism is "the differential verifiability required for recognition of profits versus losses", its extreme form is the traditional conservatism adage: "anticipate no profit, but anticipate losses" (Watts, 2003). This means earnings are recognized when they are realized, and losses are recognized immediately. One of the criticisms of conservatism is that understating earnings in the current period could lead to overstating earnings in the future. Nevertheless, we contend that the more negative the relationship between independent variables and both proxies of accounting conservatism, loss avoidance and abnormal LLPs, the more conservative the bank—with an exception for the C-score model as a dependent variable, where the relationship and the independent variables are positive. This means bank managers' ethically responsible and are acting in the best interest of shareholders (Quttainah et al., 2013). Hence, we deploy three different measures due to the absence of a generally acceptable method of testing the level of conservatism (Givoly & Hayn, 2000).

Two proxies of accounting conservatism, loss avoidance and abnormal LLPs, both stem from earnings management, which involves managing financial reporting or structuring transactions to manipulate financial results. Managers typically manage earnings either to mitigate political costs, manage the debt-to-equity ratio, and/or maximize their own benefits (Talebnia & Javanmard, 2011). The association between earnings management and conservatism is opportunistic behavior reflected in financial statements. Hence, accounting conservatism is mirrored in the negative correlation between the two proxies of accounting conservatism and the independent variables (Talebnia & Javanmard, 2011).

Managing earnings for loss avoidance is widely done in the banking industry and is related to changes in nonperforming loans (a normal or nondiscretionary component of LLPs for possible future credit losses). Loan loss accounting resonates credit-riskmanagement conduct and creates information gap between top management and stockholders (Nichols, Wahlen, & Wieland, 2009). Because this measure influences earnings, it requires the utmost degree of caution from management. In addition, this measure involves accrued interest that reflects management's assessments of current LLPs. Consequently, conservatism can be inferred from how managers account for LLPs.

Prior studies show loss-avoidance is an important benchmark for managers (see for example, Burgstahler & Dichev, 1997; Degeorge, Patel, & Zeckhauser, 1999). Consequently, Loss Avoidance equals 1 if a bank has a small return on asset (ROA) (income before taxes, scaled by total assets) between 0 and 0.01; Loss Avoidance equals 0 otherwise (Kanagaretnam, Krishnan, & Lobo, 2010). When Loss Avoidance equals 1, the organization is less conservative in accounting. When it is 0, we assume the organization does not tamper with anticipated losses and immediately acknowledges losses (see the Appendix for variable definitions).

The second measure is the abnormal (discretionary) LLP (Abnormal LLP), which measures banks' accounting conservatism. It is a frequent and widely accepted measure of banking conservatism, computed as the absolute value of the residual from the following model:

$$\text{LLP} = \beta_0 + \beta_1 \text{BegIla} + \beta_2 \text{ChangeLoan} + \beta_3 \text{NPL} + \beta_4 \text{IndNPL} + \beta_5 \text{Country} + \beta_6 \text{Year} + \varepsilon. \quad (1)$$

The residual from Equation (1) is Abnormal LLP. Because earnings management can increase or decrease income, we use the absolute value of LLP. Through regressing the differential persistence of earnings increases and decreases across banks, we estimate the association between LLPs and changes in nonperforming loans, as well as the association between loan loss allowances and total loans. Abnormal LLPs are the earnings component we expect to be managed. Existing empirical research concerning earnings management at banks indicates a positive association between the discretionary part of LLPs and earnings, which suggests banks use abnormal LLPs to manipulate earnings (Beatty, Berger, & Magliolo, 1995). Hence, the discretionary part of abnormal LLPs is negatively related to earnings, which means banks do not use abnormal LLPs to manage earnings. Disintegrating total accruals into discretionary and nondiscretionary parts, conditional accounting conservatism is primarily associated with the discretionary part of accruals, which is managed. Furthermore, prior literature indicates earnings management is absorbed in stock prices because investors anticipate managers to manipulate earnings. Conservatism may reduce managers' incentives to manage earnings.

C-Score, our third measure of accounting conservatism, is developed and implemented by Khan and Watts (2009) based on the Basu model (1997), which measures asymmetric timeliness. The C-score takes into account variations in firm-specific characteristics (size,M/B, and leverage) and year (Khan & Watts, 2009). The basic model of Basu (1997) is specified as:

$$X_i = \beta_1 + \beta_2 D_i + \beta_3 Ri + \beta_4 D_i R_i + \varepsilon_i, \qquad (2)$$

where i indicates the company, X is earnings, R is returns, and D is a binary variable that equals 1 if R < 0, and 0 otherwise. Therefore, the coefficients of Ri (β3) and Di Ri (β4) represent the good-news timeliness and the incremental timeliness for bad news over good news (i.e., conservatism), respectively. We calculate β3 and β4 as follows:

$$\text{G-score} = \beta_3 = \mu_1 + \mu_2 \text{size}_i + \mu_3 M/B_i + \mu_4 \text{leverage}_i. \qquad (3)$$

$$\text{C-score} = \beta_4 = \lambda_1 + \lambda_2 \text{size} + \lambda_3 M/B_i + \lambda_4 \text{leverage}_i. \qquad (4)$$

where Size is the natural log of the market value, M/B is the marketto-book ratio, and Leverage is the debt-to-equity ratio. Then, we replace β3 and β4, computed in Equations (3) and (4), respectively, into Equation (2). Following Khan and Watts (2009), we also include the three firm characteristics (size, M/B, and leverage) separately in Equation (2) to have better estimates of accounting conservatism. Therefore, we obtain the following regression model:

$$\begin{aligned} X_i = {} & \beta_1 + \beta_2 D_i + R_i (\mu_1 + \mu_2 \text{size}_i + \mu_3 M/B_i + \mu_4 \text{leverage}_i) \\ & + D_i R_i (\lambda_1 + \lambda_2 \text{size}_i + \lambda_3 M/B_i + \lambda_4 \text{leverage}_i) \\ & + (\delta_1 \text{size}_i + \delta_2 M/B_i + \delta_3 \text{leverage}_i + \delta_4 D_i \text{size}_i + \delta_5 D_i M/B_i \\ & + \delta_6 D_i \text{leverage}_i) + \varepsilon_i. \end{aligned} \qquad (5)$$

3.3 | Measuring independent and control variables

Following Quttainah et al. (2013) and Almutairi and Quttainah (2017), we use Islamic as a binary variable that equals 1 if the financial institution is an IB, and 0 otherwise. Board Size is defined as the total number of directors serving on the board. Moreover, independence of board directors (Board Independence) is the average tenure of all outside directors divided by the total tenure for all directors on the board (Huang, 2013). The reputation of independent directors (Board Reputation) is a binary variable equal to 1 if an independent director is also on the boards of more than three other firms (Fich & Shivdasani, 2007). The tenures of independent directors (Board Tenure) are measured as the year of annual meeting minus the start year of directorship, minus any breaks in directorship service (Huang, 2013). Following Blau index (Blau, 1977), we calculate board diversity age (Board Diversity Age) and board diversity gender (Board Diversity Gender)[9] as $1-\sum_{i=1}^{s}P_i^2$ where s is the number of categories and p is the fraction of directors belonging to category i.

As for control variables, we include several bank characteristics that could affect earnings management—specifically that both are used as proxies for accounting conservatism in the empirical analysis. We control for growth opportunities (Growth), measured as the ratio of M/B equity value from the beginning to the end of year t. Equity value, determined by the firm's growth opportunities and past asymmetric timeliness earnings, is reflected in the M/B ratio (LaFond & Roychowdhury, 2008; Roychowdhury & Watts, 2007). Lobo, Parthasarathy, and Sivaramakrishnan (2008) indicate banks with growth opportunities show more accounting conservatism in their financial reporting. In contrast, accounting conservatism is less pronounced in high-growth firms, which tend to demonstrate more aggressive reporting behavior (Lobo et al., 2008). Thus, because the link between growth opportunities and accounting conservatism is unclear, we are unable to predict the sign of Growth. Bank size (Bank Size) is measured as the natural logarithm of total assets at the end of the year.

Unlike small firms, large firms have different asymmetric timeliness of earnings (Givoly, Hayn, & Natarajan, 2007) and demonstrate less accounting conservatism as they disclose more information to the public using different methods of information dissemination (LaFond & Watts, 2008). Conversely, large firms encounter lower operational risk and thus adopt more conservative accounting practices (Callen, Segal, & Ole-Kristian, 2010). Therefore, we expect a link between growth opportunities and accounting conservatism but do not predict the sign on Bank Size.

We also control for operating cash flow (Cash Flow Change) because profitable firms tend to be more conservative in their financial reporting (A. S. Ahmed & Duellman, 2007). We compute the variableas the change in cash flows (income before taxes and LLPs) during year t deflated by beginning total assets. Further, loan loss allowance (Allowance) is controlled and calculated as total loan loss allowance at the end of year t scaled by total assets at beginning of year t, respectively. Andreou, Cooper, Louca, and Philip (2017) argue bank managers who apply accounting conservatism to their financial reporting recognize adequate LLPs consistently each period based on their forecasts of the loan loss allowance balance and expected losses. Therefore, we expect a positive link between Allowance and accounting conservatism.

In addition, we control for the risk in total assets (Risk Assets), calculated as total risk assets scaled by total assets at the beginning of year t, to reflect differences in potential risks among banks (Quttainah & Almutairi, 2017). We expect bank managers who practice accounting conservatism to be less likely to invest in risky assets. Last, we use country and year indicators to control for potential impacts of other country-level factors and year factors in our results.[10]

4 | EMPIRICAL RESULTS

4.1 | Descriptive statistics

Table 2 presents the descriptive statistics for the variables used in our tests. The mean Loss Avoidance of the IBs and CBs is 26 and 30%, respectively. Also, in the IBs, the mean Abnormal LLP and the mean Score are 0.1 and 0.9%, whereas in the CBs, the average Abnormal LLP and the average C-Score are 0.3 and 3%. These figures indicate accounting conservatism is more pronounced in IBs.

TABLE 2 **Summary statistics of the variables (n=3,772)**

	Summary statistics of the variables CBs (n = 1,886)					Summary statistics of the variables IBs (n = 1,886)				
Variable	Mean	SD	Min	Med	Max	Mean	SD	Min	Med	Max
Accounting conservatism										
Loss Avoidance	0.30	0.48	0.00	0.00	1.00	0.26	0.46	0.00	0.00	1.00
Abnormal LLP	0.003	0.07	0.00	0.00	0.34	0.001	0.05	0.00	0.00	0.34
C-score	0.03	0.95	0.05	0.10	0.79	0.09	0.69	0.07	0.15	0.99
Bank characteristics										
Log assets	12.00	4.75	9.470	7.70	12.05	16.00	5.60	8.40	9.40	14.95
Growth	0.11	0.23	0.00	0.04	0.45	0.18	0.45	0.00	0.06	0.21
Loan ratio	0.57	0.58	0.13	0.22	0.48	0.43	0.34	0.14	0.42	0.62
Cashflowchange	0.02	0.03	0.00	0.00	0.02	0.02	0.02	0.00	0.00	0.03
Allowance	0.02	0.00	0.00	0.04	0.02	0.03	0.05	0.00	0.00	0.07
Risk assets	0.68	0.36	0.52	0.61	0.77	0.37	0.25	0.38	0.46	0.56
Beglla	0.02	0.03	0.00	0.00	0.05	0.04	0.05	0.00	0.00	0.01
Change loan	−0.06	0.35	−0.08	0.00	0.00	−0.04	0.30	−0.06	0.00	0.00
NPL	0.05	0.06	0.00	0.00	0.08	0.01	0.04	0.00	0.00	0.04
IndNPL	0.40	0.35	0.00	0.00	1.00	0.20	0.29	0.00	0.00	1.00
Return	5.09	38.49	−19.33	0.66	90.50	4.69	40.42	−15.33	0.26	85.55
Board characteristics										
Board size	10.10	8.22	5.00	10.00	12.00	13.13	9.02	7.00	12.00	15.00
Board independence	0.41	0.42	0.00	0.20	0.82	0.50	0.48	0.00	0.40	0.80
Board reputation	0.10	0.08	0.00	0.09	0.13	0.20	0.16	0.00	0.19	0.22
Board tenure	5.53	2.55	0.00	6.5	12.00	6.75	1.88	0.00	5.25	14.00
Board directorag	50.94	56.67	49.00	54.73	68.00	47.48	55.86	35.00	47.00	55.00
Board director gender (female=1)	0.42	0.39	0.00	0.00	1.00	0.55	0.50	0.00	1.00	1.00

TABLE 3 **Univariate tests between Islamic banks and commercial banks**

	CBs			IBs				
	N	Mean	SD	N	Mean	SD	Diff.	t value
Loss avoidance	1,886	0.30	0.48	1,886	0.26	0.46	0.25 ***	1.94
Abnormal LLP	1,886	0.003	0.07	1,886	0.001	0.05	0.06 ***	3.02
C-score	1,886	0.03	0.95	1,886	0.09	0.69	0.062 ***	2.58
Log assets	1,886	12.00	4.75	1,886	16.00	5.60	0.08 ***	3.25
Growth	1,886	0.11	0.23	1,886	0.18	0.45	0.029 **	1.97
Loan ratio	1,886	0.57	0.58	1,886	0.43	0.34	0.24 ***	1.33
Cash flow change	1,886	0.02	0.03	1,886	0.02	0.02	0.004	1.22
Allowance	1,886	0.02	0.00	1,886	0.03	0.05	0.032 ***	2.80

Significance at the 10, 5, and 1% levels is indicated by *, **, and ***, respectively.

In addition, Table 2 shows significant differences between the two subsamples in terms of bank characteristics. For example, IBs, in comparison to CBs, are larger, have higher growth rates, hold fewer loans and larger allowances for loan losses, and invest less in risky assets. The number of IB directors, on average, exceeds the number of CB directors by two. Furthermore, IB boardrooms have higher proportions of independent directors than those of CBs. In addition, independent directors in IBs enjoy longer board tenures and maintain better reputations than their CB counterparts. Although the average director age in both types of banks falls between 30 and 50 years (Ford, 1992), the average director age is smaller in IBs. Younger directors may enjoy more mental and physical stamina to accept new ideas and learn new behaviors (Koufopoulos, Zoumbos, Argyropoulou, & Motwani, 2008). This should be more pronounced in IBs because Islamic banking is growing in size and appeal, even in non-Muslim countries.

TABLE 4 **Pearson correlation matrix for the variables used in the regression analysis**

		1	2	3	4	5	6	7	8	9	10	11	12	13	14
1	Loss avoidance	1.00													
2	Abnormal LLP	0.15	1.00												
3	C-score	0.09	0.09	1.00											
4	Islamic	−0.05 ***	−0.07 **	0.34 ***	1.00										
5	Board size	−0.10 ***	−0.10 **	0.09 †	−0.14 **	1.00									
6	Board independence	−0.08 **	−0.09 ***	0.23 ***	−0.27 **	−0.29 **	1.00								
7	Board reputation	−0.12 **	−0.11 **	0.03 **	−0.1100 *	−0.10 ***	−0.13 **	1.00							
8	Board tenure	−0.13 ***	−0.23 **	0.10 **	−0.25 **	−0.45 **	−0.39 †	−0.50 **	1.00						
9	Board diversity age	−0.26 ***	−0.22 ***	0.63 ***	−0.69 ***	−0.57 ***	−0.45 ***	−0.47 ***	−0.50 ***	1.00					
10	Board diversity gender	−0.05 **	−0.12 **	0.11 **	−0.25 **	−0.06 †	−0.04 †	−0.20 ***	−0.21 ***	−0.09 ***	1.00				
11	Bank size	0.13 ***	0.04	0.07	0.09 ***	0.00	0.02	0.04 †	0.72 ***	0.70 ***	0.01	1.00			
12	Growth	−0.070 *	−0.05 †	0.03 **	−0.15 *	−0.24 ***	−0.28 ***	−0.30 **	−0.94 **	−0.91 **	−0.11 **	−0.01	1.00		
13	Cash flow change	−0.15 **	−0.30 **	0.07 ***	−0.10 **	−0.23 **	−0.30 **	−0.40 ***	−0.54 ***	−0.61 **	−0.41 †	−0.08 †	0.04	1.00	
14	Allowance	0.24 **	0.14 **	0.11 **	0.26 **	0.40 **	0.37 **	0.32 **	0.64 **	0.10 †	0.03	0.00	0.31	0.09	1.00
15	Risk assets	0.04	0.05	0.09 **	0.05 *	0.07 **	0.12 ***	0.46 ***	0.18 ***	0.21 ***	0.18 ***	0.16 ***	0.00	0.07 †	0.03

Significance at the 10, 5, and 1% levels is indicated by $^{\dagger}p = .10$, $^{*}p = .05$, $^{**}p = .01$; $^{***}p = .001$, respectively.

TABLE 5 Impact of Islamic banks on accounting conservatism

Variables	(1) Loss avoidance	(2) Abnormal LLP	(3) C-score
Islamic	−0.54 ***	−0.36 **	0.15 ***
	(−4.50)	(−3.33)	(2.19)
Bank size	1.69 **	0.65 *	0.98 **
	(7.03)	(5.80)	(2.95)
Growth	0.89	0.54 *	0.52 *
	(−3.19)	(3.18)	(0.35)
Cash flow change	−9.05 **	−11.75 **	8.00 ***
	(−7.05)	(−5.58)	(4.98)
Allowance	−7.64 *	−0.77	7.55
	(−7.21)	(−3.00)	(3.40)
Risk assets	0.30	0.77 **	0.92 **
	(0.91)	(5.50)	(1.91)
Country and year effects	Y	Y	Y
Observations	3,772	3,772	3,772
Adj. R^2	0.36	0.35	0.30

Heteroskedasticity robust t-statistics or z-statistics are in parentheses. Significance at the 10, 5, and 1% levels is indicated by *, **, and ***, respectively.

IBs boardrooms also tend to have more female directors than CBs have. This may create a better general picture of how women in Islam can hold decision-making positions and contribute positively in society.

Table 3 depicts univariate tests between CBs and IBs. It shows the mean Loss Avoidance values of CBs and IBs are 30 and 26%, respectively, with a statistically significant difference at the 1% level. Furthermore, the mean Abnormal LLP value is 0.1% for CBs compared to 0.3% for IBs, with mean difference significant at the 1% level. For the third proxy of accounting conservatism, C-Score, the mean is 3% for CBs compared to 9% for IBs, with mean difference significant at the 1% level. These preliminary findings indicate IBs have more conservative accounting policies than CBs, which, albeit initially, supports Hypothesis 1.

4.2 | Main results

Next, we generate a pairwise correlation matrix to ensure no significant association exists between the dependent and independent variables. It provides great insights, albeit prior to performing any univariate tests or regression techniques. Pearson correlation coefficients are shown in Table 4. All correlations between Islamic and conservatism measures are statistically significant (p-value < .001). These preliminary findings suggest IBs managers practice more accounting conservativism in their financial reporting than their CBs counterparts. In addition, Board Size, Board Independence, Board Reputation, Board Tenure, Board Diversity Age, and Board Diversity Gender are all statistically related to the conservatism measures. Collectively, these preliminary results also support Hypotheses 2 through 6.

To see whether multicollinearity exists among variables, we follow the procedure in Hair, Black, Babin, Anderson, and Tatham (1998).

The analysis calculates variance inflation factor (VIF) values for two models. All VIF values in Table 4 are lower than the threshold value of 10, suggested by Hair et al. (1998). Table 5 shows the results of OLS cluster robust standard error estimation, assessing and comparing how corporate governance internal mechanisms affect IBs compared to CBs on accounting conservatism by using three different measures. The table presents unstandardized beta coefficients and standard errors (in parentheses) along with the significance levels of the coefficients. Columns 1, 2, and 3 show the results of the effects of internal governance mechanisms on accounting conservatism using three different measures: Loss Avoidance, Abnormal LLP, and C-Score, respectively.

Hypothesis 1 predicts IBs are more conservative in their financial reporting compared to CBs. The coefficient on Islamic is negative and statistically significant for Loss Avoidance at p-value < .001 and for Abnormal LLP at p-value < .05. Under the C-Score measure, Islamic is positive and statistically significant at p-value < .001. These results show Islamic has a positive impact on accounting conservatism regardless of whether the regression is adjusted for country and year effects and is robust to the inclusion of various control variables. Hence, the results reported in columns 1, 2, and 3 suggest a one-unit increase in Islamic is associated on average with a 54%, 36%, and 15%, respectively, increase in the likelihood of being more conservative on accounting reporting. This is consistent with AlAbbad (2016) findings that due to higher litigation risks, IBs have more conservative financial statements than CBs do.

Prudent management of an IB's assets and liabilities does not violate the legitimacy of Shari'ah so long as IB management is just in dealing with all depositors (K. Hassan & Lewis, 2009). Adhering to Islamic principles requires more conservatism to reduce managers' tendency and ability to manipulate accounting figures. Therefore, on average, a one-unit increase in IBs is associated with 35% increase in accounting conservatism, which consequently increases the quality of financial data disclosure. Hence, Hypothesis 1 is supported. As for the control variables, overall, their coefficients are statistically significant and in line with those reported in prior studies.

Table 6 shows regression results for Hypotheses 2 through 6. We present the regression results separately for each of our three conservatism measures. Hypothesis 2 predicts Board Size influences accounting conservatism. Under the first and second models, the sign of Board Size is negative and significant at p-value < 10 and 5%, respectively, suggesting increases in IBs board size have an adverse effect on managers' incentives to manipulate the accounting reporting process. These findings in turn indicate IBs board size does influence monitoring management behavior in manipulating revenues. Birnbaum (1984) finds banks with large boards are less risky, and Chen and Jaggi (2000) contend larger boardrooms are associated with less information asymmetry. Additionally, the result is consistent with Pfeffer and Salancik (2003), suggesting large boards are better at budgeting,

TABLE 6 The association between internal governance mechanism and accounting conservatism

Variables	(1) Loss avoidance	(2) Abnormal LLP	(3) C-score
Board size	−0.33 *	−0.11 **	0.46 ***
	(−1.45)	(−4.32)	(3.00)
Board independence	−1.49 **	−0.18 **	9.80 ***
	(−0.83)	(−1.63)	(9.02)
Board reputation	−0.91 **	−0.052 *	6.33 **
	(−1.95)	(−1.95)	(6.40)
Board tenure	−1.50 **	−0.53 **	0.75 ***
	(−2.39)	(−3.85)	(8.33)
Board diversity age	−0.85 **	−0.99 ***	0.85 **
	(−2.10)	(−1.92)	(0.18)
Board diversity gender	−0.372 *	−0.001 ***	0.033 ***
	(−1.77)	(−3.12)	(4.25)
Bank size	1.59 ***	0.53 **	0.25 **
	(5.03)	(4.48)	(2.94)
Growth	0.89	0.16 *	0.39 **
	(−1.99)	(2.08)	(0.53)
Cash flow change	−15.85 ***	−14.75 ***	8.11 **
	(−4.95)	(−7.48)	(5.10)
Allowance	−5.44 *	−0.97	6.34
	(−4.11)	(−1.64)	(2.24)
Risk assets	0.305	0.89 **	0.45 **
	(0.61)	(2.05)	(2.17)
Country and year effects	Y	Y	Y
Observations	1,886	1,886	1,886
R^2	0.46	0.43	0.47

Heteroskedasticity robust t-statistics or z-statistics are in parentheses. Significance at the 10%, 5%, and 1% levels is indicated by *, **, and ***, respectively.

raising external capital, and managing leverage. Accordingly, greater board size positively influences ethical reporting practices. Under the C-Score model, Board Size is positive and statistically significant at p-value < .01, indicating larger boards increase accounting conservatism. This finding is also consistent with Boussaid et al. (2015), suggesting larger boards reduce accounting reporting risks and ensure conservative accounting practices. In sum, there is a relationship between accounting conservatism and board size, supporting Hypothesis 2.

Hypothesis 3 indicates there is a positive relationship between board independence and accounting conservatism. Board Independence is negatively and statistically related to Loss Avoidance and Abnormal LLP at p-value < .05. Our results are consistent with those reported in Peasnell, Pope, and Young (2000) and Quttainah et al. (2013), which show the presence of independent directors has a negative relationship with income-increasing earnings management and loss avoidance activities. Also, our findings are line with those reported by Quttainah and Almutairi (2017), Klein (2002), and Xie et al. (2003), who show an inverse relationship between earnings management and the presence of independent directors.

As for the C-Score measure, the coefficient on Board Independence carries a positive sign (p-value < .01), suggesting IBs with a greater number of independent directors apply more conservative practices in their financial reporting. This result is consistent with Beekes et al. (2004), which shows boards with a higher proportion of independent directors are more likely to recognize bad news in earnings on a timely basis.

In sum, in IBs, independent directors not only curb the temptation to manage earnings, but also incentivize managers to adopt more conservative accounting practices. Therefore, the more independent directors an IB board has, the more conservative the IB becomes in its accounting reporting, supporting Hypothesis 3.

Hypothesis 4 envisages a positive relationship between independent director reputation and ethical reporting in accounting conservatism. Columns 1 and 2 of Table 6 show Board Reputation is economically negative and significantly related to Loss Avoidance at the 0.05 level, and Abnormal LLP at the 0.10 level. For the C-Score measure, as shown

in column 3, Board Reputation is positive and statistically significant at p-value < .05.

Independent directors bring more resources to the firm as well as they are better monitors over managements' acts (Fama & Jensen, 1983). Multiple directorships can, therefore, lead to an immediate increase in the effectiveness of board monitoring (Shivdasani, 1993). Our findings are in line with those reported in Masulis and Mobbs (2011) and Mobbs (2013). Their results indicate a board member with multiple directorships makes better decisions and monitors executive management, including the CEO, more carefully. In short, our results in Table 6 suggest reputable independent directors in IBs are more likely to enhance and support the adoption of conservative accounting policies. Hence, Hypothesis 4 is supported.

Hypothesis 5 relates to the link between independent director tenure and accounting conservatism. Columns 1 and 2 of the same table show Board Tenure is negatively related to Loss Avoidance and Abnormal LLP, respectively. Both relationships are statistically significant at a p-value < .05. In column 3, Board Tenure has a positive and significant association with C-Score at the 0.01 level. This suggests tenured independent directors exert a negative influence on IB executives' self-serving accounting practices. That is, the longer an independent director's tenure is, the more conservative the IB's managers are when it comes to financial reporting. Our findings coincide with those reported by prior studies, which indicate tenured directors are effective monitors and thus better able to detect fraud (Beasley, 1996; Berberich & Niu, 2011; Bonini et al., 2015; Rutherford & Buchholtz, 2007; Schnake et al., 2005; Sharma, 2011; Vafeas, 2003). Additionally, our findings are consistent with Bonini et al. (2015), which finds tenured independent directors are better monitors and have the ability to gather, maintain, and share valuable information about the firm in ways that build stability; they also have more knowledge about the company, have more governance experience, and contribute more to boardroom discussions. Thus, Hypothesis 5 is supported.

Table 6 also shows the results of the impact of board diversity in terms of age and gender on accounting conservatism. Under the first and the second measures of accounting conservatism, the coefficient on Board Diversity Age is negative and statistically significant at the 0.05 level and the 0.01 level, respectively. Nonetheless, in the C-Score model, Board Diversity Age is positive and economically significant at p value < .05. Such findings suggest greater age diversity on the board contributes to more conservative accounting practices in IBs. Wider diversity in board director age may bring different life insights and perspectives, which encourages a culture of discussion and debate, enhances the overall problem-solving capacity in boardrooms, and hence increases directors' monitoring skills to prevent misconduct. It could also serve as a check on management attempts to engage in profitable business opportunities without ethical constraints.

Moreover, Table 6 shows Board Diversity Gender is negatively and significantly related to Loss Avoidance (p-value < .10) and to Abnormal LLP (p-value < .01). For the C-Scoremodel in column 3, Board Diversity Gender is positive and statistically significant at p-value < .01. This suggests gender diversity on the board improves monitoring, which in turn is likely to require a higher degree of verification for reporting good news rather than bad news in financial statements. In sum, accounting conservatism in IBs is higher when their boards are highly diversified in age and gender. Thus, Hypothesis 6 in its null form is rejected. As for the control variables, in general, they all seem to carry their expected signs.

4.3 | Robustness tests

We perform further tests to see whether our prior results hold. First, we rerun a precrisis and postcrisis regression to see whether the 2008 global financial crisis affects the association between IBs characteristics and accounting conservatism. Therefore, we follow Beltratti and Stulz (2009), Fahlenbrach and Stulz (2011), and Francis et al. (2013) in dividing the sample into two different subsamples covering two different periods. The first subsample covers the period from 1993 until the end of 2006. The second subsample covers the period from 2007 until 2015. Our results as shown in Table 7 indicate the relationship.

TABLE 7 **The influence of Shari'ah Compliant Banks' Board characteristics on accounting conservatism; pre-financial crisis an post-financial crisis**

	Before financial crisis			During and after financial crisis		
Variables	(1) Loss avoidance	(2) Abnormal LLP	(3) C-score	(1) Loss avoidance	(2) Abnormal LLP	(3) C-score
Board size	−0.05 **	−0.23 **	0.055 **	−0.031 **	−0.053 **	0.14 **
	(−3.62)	(−6.13)	(3.29)	(−4.19)	(−3.07)	(6.22)
Board independence	−0.198 ***	−0.44 **	0.44 **	−0.049 ***	0.29 **	0.86 **
	(−4.81)	(−2.74)	(0.33)	(−8.13)	(−7.45)	(3.57)
Board reputation	−0.01 **	−0.21 **	0.49 ***	−0.16 **	−0.31 **	0.58 **
	(−2.68)	(−4.27)	(3.26)	(−7.10)	(−6.52)	(3.83)
Board tenure	−0.005 **	−0.175 **	0.215 **	−0.54 *	−0.53 *	0.68 *
	(−1.04)	(−8.99)	(5.05)	(−5.79)	(−7.44)	(6.80)
Board diversity age	−0.041 *	−0.41 **	0.73 **	−0.05 **	−0.030 *	0.040 *
	(−3.76)	(3.81)	(4.29)	(−2.77)	(−2.70)	(5.76)
Board diversity gender	−0.09 **	−0.051 ***	0.38 **	0.041 *	−0.007 *	0.056 *
	(−2.87)	(−7.37)	(2.22)	(2.42)	(−5.87)	(5.20)
Bank size	0.05**	0.121 **	0.086 **	0.0020 *	0.022 *	0.060 *
	(4.12)	(6.25)	(5.19)	(2.25)	(2.58)	(2.66)
Growth	−0.18 **	−0.29 ***	0.54 ***	−0.005 ***	−0.035 ***	0.065 ***
	(−4.81)	(−4.35)	(5.14)	(−4.82)	(−4.01)	(7.14)
Cash flow change	−0.04 **	−0.28 **	0.014 **	−0.050 ***	−0.45 ***	0.36 ***
	(−3.96)	(−13.85)	(4.10)	(−13.90)	(−15.00)	(11.09)
Allowance	0.02	0.071 *	0.034 **	0.001 ***	0.130 ***	0.150 ***
	(0.23)	(6.95)	(5.09)	(4.13)	(6.15)	(8.70)
Risk assets	0.080 **	0.03 *	0.05 **	0.029 **	0.330 ***	0.334 **
	(3.83)	(2.21)	(3.37)	(2.69)	(3.40)	(6.90)
Country and year effects	Y	Y	Y	Y	Y	Y
Observations	1,066	1,066	1,066	656	656	656
Adj. R^2	0.40	0.39	0.35	0.30	0.31	0.32

Heteroskedasticity robust t-statistics in parentheses. Significance at the 10, 5, and 1% levels is indicated by *, **, and ***, respectively.

between board characteristics and accounting conservatism remains the same in the precrisis and postcrisis periods. IB board traits prior to the financial crisis reflect strong ethical standards that stem from Shari'ah. The continuous association in the postcrisis period indicates consistent ethical guidance and that board characteristics and traits shape manager behaviors.

Next, we use two additional measures of accounting conservatism. First, we use the basic model of Basu (1997), which defines the state in which future bad news is expected as one in which current stock returns are negative. Despite the widespread use of the Basu model, the validity of its differential timeliness coefficient has been questioned (see, for example, Dietrich et al., 2007; Givoly & Hayn, 2000) Nevertheless, some recent studies (e.g., Ball, Kothari, & Nikolaev, 2011; Ettredge et al., 2012) find the Basu model useful. Second, we follow Francis et al. (2013) in deploying Coefficient_Basu, which is based on an organization-specific Basu model. To derive the estimation for each organization, we run the Basu model for each bank from 1993 to 2015.

$$X_{i,t} = \beta_1 i + \beta_{2i} D_{i,t} + \beta_{3i} R_{i,t} + \beta 4t D_{i,t} R_{i,t} + \varepsilon, \qquad (6)$$

where i refers to the bank, t refers to the year, X is earnings, R is returns, and D is a dummy variable that equals 1 if R is less than 0, and 0 otherwise. This regression refers to how sensitive earnings is to news. The sensitivity of earnings to good news is captured by β3i, and earnings sensitivity to bad news is captured by β3i + β4t. Hence, the relationship between earnings sensitivity to bad news and earnings sensitivity to good news is indicated by:

$$\text{Coefficient}_{\text{Basu}} = (\beta_{3i} + \beta_{4i})/\beta_{3i}, \qquad (7)$$

where the higher Coefficient_Basu is, the more conservative the bank is (Francis et al., 2013).Table 8 reports the relationship between IB board characteristicsand accounting conservatism using the two additional measures of accounting conservatism. Our results in Table 8 are in line with thosereported in Table 6.

5 | CONCLUSION

We investigate the relationship between corporate governance and accounting conservatism in Islamic banking. In particular, we examine whether IBs engage in more conservative accounting practices than CBs do. We also investigate whether IB board characteristics influence accounting conservatism. Our study contributes to the extant literature on the link between corporate governance and accounting information. In addition, we contribute to the growing literature in Islamic banking and its impact on the quality of accounting information. We provide evidence that IBs are more conservative than CBs in their financial reporting practices. The internal governance mechanisms of IBs dealing with microregulations and macroregulations extend to building and strengthening the ethical and moral aspects of reporting processes.

TABLE 8 The impact of Islamic Banks'Board characteristics on accounting conservatism using two different accounting conservatism measures

Variables	(1) Basu 's	(2) Coefficient_Bassu
Board size	0.43***	0.21 ***
	(4.94)	(7.13)
Board independence	5.30 ***	0.54 **
	(5.92)	(5.74)
Board reputation	4.44 **	0.031 ***
	(4.40)	(4.27)
Board tenure	0.55 ***	0.75 ***
	(3.33)	(7.99)
Board diversity age	0.77 **	0.061 ***
	(0.88)	(2.81)
Board diversity gender	0.029 ***	0.051 ***
	(5.05)	(4.37)
Bank size	0.55**	0.033
	(4.94)	(2.11)
Growth	0.19**	0.033
	(0.33)	(2.09)
Cash flow change	11.51 **	0.329
	(8.81)	(0.37)
Allowance	4.44	0.073
	(1.04)	(5.22)
Risk assets	0.66 **	0.022
	(7.77)	(3.55)
Country and year effects	Y	Y
Observations	1,556	1,556
R^2	0.42	0.39

Heteroscedasticity robust t-statistics in parentheses. Significance at the 10, 5, and 1% levels is indicated by *, **, and ***, respectively.

We document empirical evidence suggesting Shari'ah, the internal board structure, and the proportion of nonexecutive directors have positive impact on accounting conservatism and affect a board's ability to monitor senior management. In other words, Shari'ah influences the reporting conservatism process and allows Islamic Banks to maintain higher ethical standards. Such higher ethical standards complement a positive relationship between effective internal governance such as reputation, tenure, board diversity, and monitoring of management that appears conservative in accounting tendencies. Whereas accounting manipulation is the outcome of a desire to affect wealth transfers between various stakeholders. According to Quttainah et al. (2013), CBs have several incentives to engage in earnings management, such as reducing political costs, limiting debt-to-equity ratios, and increasing management's compensation and destroying shareholder value.

Our study has several implications for regulators, corporate managers, and board of directors. For regulators, accounting conservatism should be viewed as an additional prudential regulatory tool to mitigate managements' acts and hence improve the quality of financial reporting. Corporate managers can implement conservative accounting practices to avoid any future financial failures and litigation risks as a result of disclosing distorted financial reports. For board of directors, enhancing certain characteristics of board directors should reduce agency costs and improve overall corporate efficiency.

The key limitation of this study is two-fold. First, because leverage is defined in a more conventional matter; as the debt to equity ratio, it is possible that Islamic Banks are more conservative in comparison to commercial banks because the nature of their assets and the nature of how their loans are financed. Unlike commercial banks, IslamicBanks' transactions are based on equity financing and this fact has less credit risk, which conforms to Shari'ah. Second, another possible conservatism is the relative ratings of different banks within the sample. Hence, a possible future research is to examine the effects of leverage and relative ratings of banks on accounting conservatism.

6 | ENDNOTES

1 The Sarbanes–Oxley Act of 2002 (Pub.L. 107–204, 116 Stat. 745, enacted July 30, 2002), also known as the "Public Company Accounting Reform and Investor Protection Act" (in the Senate) and "Corporate and Auditing Accountability, Responsibility, and Transparency Act" (in the House) and more commonly called Sarbanes–Oxley, Sarbox or SOX, is a United States federal law that set new or expanded requirements for all U.S. public company boards, management and public accounting firms. There are also a number of provisions of the Act that also apply to privately held companies, for example the willful destruction of evidence to impede a Federal investigation (Sarbanes, 2002).

2 The Organization for Economic Cooperation and Development (OECD) refers to corporate governance as "the internal means by which corporations are operated and controlled" (OECD, 2004). The Cadbury Report (1992) defines corporate governance as "the system by which companies are directed and controlled." Recent work on corporate governance comes from the IMF, World Bank, Basel Committee on Banking Supervision, The Joint Forum, and the Sarbanes-Oxley Act of 2002. In the context of Islamic financial institutions (IFIs), corporate governance is "a set of organizational arrangements whereby the actions of the management of IFS are aligned, as far as possible, with the interests of its stakeholders; provision of proper incentives for the organs of governance such as the [board of directors], Shari'ah board and management to pursue objectives that are in the interests of the stakeholders and facilitate effective monitoring, thereby encouraging IFIs to use resources more efficiently; and compliance with Islamic Shari'ah rules and principles," (IFSB, 2006). Shari'ah is a legal system consistent with a code of ethics derived from the Quran (the Muslim holy book) and sunna (the daily practice of the Prophet Mohammad).

3 There are many incidences of this contagious effect, such as Lehman Brothers (U.S.), Kaupthing, Landsbanki and Glitnir (Iceland), Royal Bank of Scotland Group (Scotland), Banco Privado Português (Portugal), etc. (Carretta, Fiordelisi, & Schwizer, 2017; Dodo, 2017; Mayes, 2017).

4 García Lara et al. (2016) show firms with conservative accounting policies have a higher probability of raising more capital. Cho and Choi (2016) report that firms with smaller managerial holdings and foreign investor holdings adopt conservative accounting practices that lower overinvestment. In addition, Chen et al. (2013) document firms following conservative accounting policies significantly increase hurdle rates used to value investment projects and promote conservative investment decisions.

5 Zakat is an annual levy or almsgiving and is one of the five pillars of Islam. It is customarily 2.5% of a Muslim's total wealth above a minimum acceptable standard of living known as nisab. Zakat is required to purify Muslims spiritually and physically from stinginess and to help the poor in their community. In countries where the state does not require financial institutions and citizens to pay zakat, IBs collect and deposit zakat in a zakat reserve and distribute it to poor and needy Muslims through various local and international charitable agencies (Hasan, 2010).

6 Profit-sharing investment accounts are restricted and unrestricted. The restricted accounts are similar to nondiscretionary wealthmanagement accounts offered by private banks. IBs manage this type of account under an Islamic contractual system known as murabaha. Unrestricted investment accounts are similar to discretionary wealthmanagement accounts offered by private banks. For reporting purposes, IBs report unrestricted profit-sharing accounts on their statements of financial position but treat restricted accounts as offbalance sheet funds (Archer & Abdel Karim, 2009)

7 Following several major corporate failures and scandals, numerous scholars suggest the need for integrating ethics into corporate overnance (e.g., Arjoon, 2005; Cladwell & Karri, 2005; Drennan, 2004; Sullivan & Shkolnikov, 2007). The literature addresses several models that provide possible solutions to agency problems such as the takeover model, the blockholder model, board models, executive compensation models, multiconstituency models (Becht & Barca, 2001), the Anglo-Saxon model, the Germanic model, the Japanese model, the Latin model, and the Confucian model (Lewis, 1999). They all tend to resolve agency problems, but they fail to integrate ethics as an essential dimension of corporate governance (Hasan, 2012). In Western theories, utilitarianism, relativism, and universalism are the foundations of ethics (Beekun, 1996). Social interaction, human reason, and experiences construct all ethical principles applicable to corporate governance that are extracted from these theories (Hasan, 2012). Unlike Western models, the Islamic model of corporate governance emphasizes ethics endorsed by Islamic law (i.e., Shari'ah). Islamic ethics are divine and religious construct, whereas Western ethics are social values and more transitory in nature (Wilson, 2002). The law in Western countries can be altered, because man and the institutions of manare the lawmakers. But for Muslims, Allah (God) is the only lawmaker (Perry, 2011). In Islam, the will of Allah, revealed to mankind through Prophet Mohammad, is the only valid source of Shari'ah. Shari'ah dominates all spheres of Muslims' daily lives, including social matters and commercial transactions. Accordingly, Muslim actions must conform to Shari'ah principles.

8 Shari'ah is a legal system consistent with the Quran (the holy book of Muslims) and sunna (the daily practice of the Prophet Mohammad). It forbids charging interest and investments in gambling, alcohol, and pornography, as well as certain other activities.

9 We first measure director age based on directors born during the same period of time, which are 5-year periods starting from 1940, 1945, 1950, 1955, 1960, 1965, and 1970. Then, we use the standard deviation as a proxy for age diversity. Additionally, gender measurements are based on a two-group measure, which is a female and a male.

10 We use the OLS cluster robust variance, as it is consistent with the fixed-effects estimator. Linear regression models require a linear association between dependent and independent variables (i.e., no serial correlation independence of the errors, constant variance (homoscedasticity) of errors versus time and any explanatory variables, and normal error distribution). In pooled OLS, the estimator must be consistent and unbiased. Thus, the errors in each time period should not be related to the independent variables in the same time period (Wooldridge, 2003). This technique agrees with Stock and Watson (2002), who show that the standard method of calculating heteroscedasticity-robust standard errors for the fixed-effects estimator generates inconsistent variance estimates.

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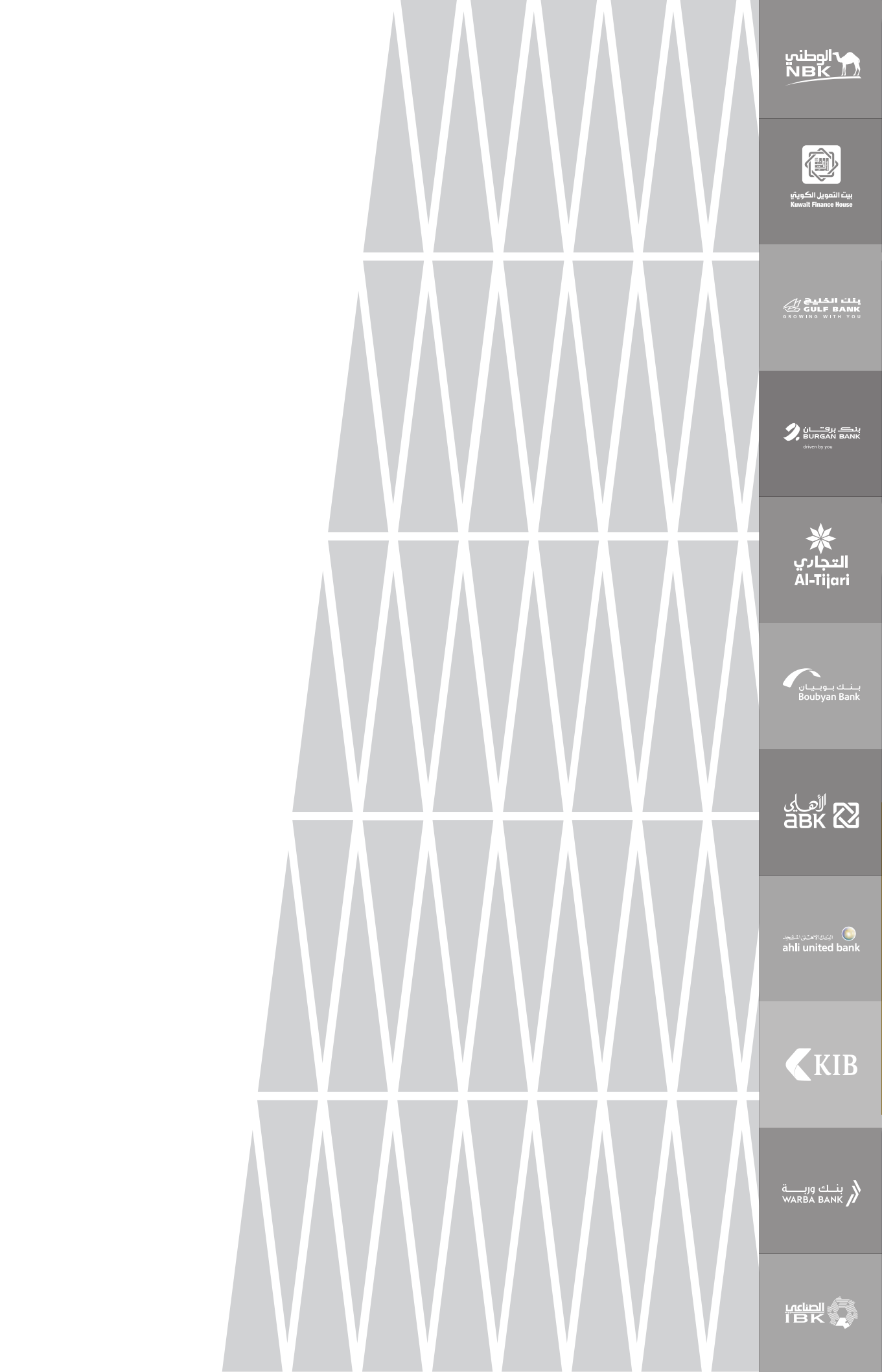
How to cite this article: Almutairi AR, Quttainah MA.

Corporate governance and accounting conservatism in Islamic banks. Thunderbird Int. Bus. Rev. 2019;1–20. https://doi.org/10.1002/tie.22063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EFFECT OF MARKET AND CORPORATE REFORMS ON FIRM PERFORMANCE:
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EFFECT OF MARKET AND CORPORATE REFORMS ON FIRM PERFORMANCE: Evidence From Kuwait

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أثر الإصلاحات السوقية والمؤسسية على أداء الشركات:
دليل من الكويت

قامت دول عديدة، على إثر الأزمة الاقتصادية العالمية في 2008، بإصلاحات اقتصادية وعلى مستوى الشركات لفرض عدالة السوق والحد من خطورة سوء السلوك الإداري لمدراء الشركات.

ضمن هذا الإطار، قامت دولة الكويت بسن قانونين لإعادة هيكلة أسواقها المالية لتحقيق تلك الأهداف وتحسين حوكمة الشركات. هذان القانونان هما قانون هيئة أسواق المال وقانون الشركات الكويتية.

نسعى في هذه البحث للإجابة عن سؤالين رئيسيين،

(1) هل تحسن أداء الشركات المدرجة في سوق الكويت للأوراق المالية بعد تطبيق هذين القانونين بعد الأزمة الاقتصادية العالمية؟

(2) هل كان لهذين القانونين أثر مباشر في تغيير أداء الشركات؟

يقدم هذا البحث دليلا علميا على وجود بعض التغيرات في أداء الشركات بعد تطبيق القانونين. كما يقدم هذا البحث دليلا على جدوى تطبيق قانون الشركات في تحسين الأداء.

على النقيض من ذلك، لم يجد هذا البحث دليلا على جدوى قانون هيئة أسواق المال في تحسين أداء الشركات.

كما يقدم البحث بعض التفسيرات والانعكاسات التطبيقية والأكاديمية والتوصيات المبنية على النتائج.

ABSTRACT

Following the global financial downturn in 2008, many countries have introduced economic and corporate reforms to assure fair markets and mitigate the risk of management misconduct. In this context, Kuwait has implemented two new major laws to restructure its capital markets and improve corporate governance. The two laws are the capital market authority law (**CMAL**) and Kuwait companies law (**KCL**). In this paper, we sought answers to two questions:

(1) has the performance of the listed companies changed in response to the enforcement of the laws?

And (2) was there a direct influence of the laws on that change?

We found some evidence of significant change in performance. Moreover, we provide evidence of **KCL** viability as a determinant of better performance. Interestingly, **CMAL** was found to be inadequate for improving firm performance. Implications and recommendations for further research are provided.

Keywords: Corporate governance, Firm performance, Market reforms, Corporate reforms

JEL: G30, G34, G38

INTRODUCTION

It is widely accepted that value maximization is the ultimate goal of business firms. Owners of these firms usually hire professionals to manage the business. When these managers do not act i the best interest of the owners, the firm is said to suffer from agency problems. Corporate governance (CG) is the set of rules and regulations by which a firm is directed and controlled to protect owners' interests and avoid agency problems and managers' misconduct. Financial markets and certainly business firms operating under weak governance are more vulnerable to exploitation and abuse. Recent global market and corporate financial regulatory reforms were the results of the latest mega business scandals and global financial distresses.

Ever since the pioneering work of La Porta et al (1999a), an extensive research was conducted to explore how firm value can be influenced by the introduction of new CG rules and regulations. Evidence of the effect, however, is inconclusive. For example, La Porta et al (1999b) found that stronger governance practices provides positive signal to the market, leading to value appreciation. Wang et al (2011) provides evidence of association between governance reforms and better performance. Others believe that corporate governance (ownership concentration) or lack of it is irrelevant to firm value (Omran, et al 2008). Another argument against a very strict governance code and heavy market regulations was raised by Carney (2006). Others (Bruno & Claessens, 2010) argue that the level of corporate governance strength, at the country and company level, may have different impact on performance. Indeed, negative effects are possible for some firms. Their results implied that a stringent regulation can harm the performance of companies with strong governance structure and has no effect on companies with poor governance structure. A similar conclusion can be found in Brickley et al (1997) and Jomini (2011)

The key question here is, how much CG rules and regulations should firms apply before harming financial results and the desired goal of value maximization?

In this paper, we attempt to contribute to the possible answers to this question with regard to less developed markets. These markets had less attention from researchers mainly because of the lack of adequate information on corporate governance factors. The scoPE of our research is limited to the Kuwait stock exchange (KSE) after the implementation of the new Capital Market Authority Law (CMAL) applied in 2010 and Kuwait Companies' law (KCL) introduced in 2012. Our aim is to explore the possible effects of applying the new laws on the performance of the firms listed in the KSE.

In the next section, we discuss the relevant literature with the goal of developing our research hypotheses. We then relate these hypotheses to the CG articles included in the CMAL and KCL while discussing the new regulations. In the following section, we provide a discussion of our data, test variables and methodology. We then discuss the results in the following section. Finally, we end with concluding remarks, implications and recommendations.

1.0 LITERATURE REVIEW

The literature on CG was initiated by La Porta et al (1999a) who used data on ownership structures of large corporations in 27 wealthy countries excluding insignificant market of Kuwait, UAE and Saudi Arabia. The main finding was that "controlling shareholders typically have power over firms significantly in excess of their cash flow rights, primarily through the use of pyramids and participation in management". This result was later confirmed by Al-Deehani and Al-Saad (2007) for Kuwait. Using data of the same sample of La Porta et al (1999a), La Porta et al (1999b) explored investor protection and corporate valuation and found evidence of positive relations between higher valuation and better protection of minority shareholders. The question, however, is do CG rules and regulations, always, lead to better corporate values while preserving owners' interests?

This question is addressed by Daines (2001). He examined the effect of Delaware corporate law on firm value using Tobin's Q as a proxy for firm value. The evidence supported the view that firms incorporated in Delaware worth significantly higher than firms incorporated elsewhere. Delaware law is considered one of the best corporate laws as it attracts more than 50% of public firms incorporated in the US. Clear and well known rules, courts precedent and quick rules update are among the reasons for its attractiveness. Moreover, Delaware State has a specialized Chancery Court for resolving corporate disputes. Accordingly, the evidence indicates that corporate law quality, which fairly protect

investors, create positive investment environment that promote firm value hence increasing investor return.

Several CG factors were tested and their effects on firm value were assessed. One CG variable is associated with board size. There are two conflicting evidence regarding board size. The first argues that smaller board-size-firms are generally associated with better performance (Yermack, 1996; Jensen (1993), Eisenberg (1988) and Singh & Davidson 2003; whereas the second argues that larger boards are associated with stronger firm performance (Zahra and Pearce, 1989, Kiel & Nicholson, 2003; Coles et al, 2008). Another variable is associated with the leadership structure of the CEO to avoid conflict of interest and hence, lower agency cost. For better governance, regulators and institutional investors enforce firms to separate the positions of board member and CEO as it is easier to abuse power and authority for self-interest when one person is holding the two positions. In fact, the majority of empirical evidence supports the separation of the two positions. Dahya et at (2009) showed that market regulators in 15 developed markets separated the positions of CEO and chairperson. Chen, Lin & Yi (2008) showed that many firms in the period from 1999 to 2003 altered their policies and bylaws to change the leadership structure from duality to non-duality. Jensen (1993) argued that duality would mitigate the monitoring role of the board and supervision of management and hence, increase agency cost. Another key component of governance framework is board independence and the presence of independent directors. Beasley (1996) examined the relation between board structure and financial scandals and found that the higher the percentage of independent directors the lower the cases of financial manipulation. Daily et al (2003) argue that, during financial crisis, firms with more independent directors have lower probability of facing bankruptcy. Investigating the risk faced by investors, La Porta et al (2002) found evidence of positive relation between higher valuation and better protection for minorities. Risk facing investors was also addressed by Emil et al (2014). Bhagat & Black (2001) explored the relation between the ratio of independent directors and short -term performance. They documented a positive relation between the presence of independent directors and performance. Wu, Lin, Lin & Lai

(2010) examined the impact of corporate governance mechanism on firm performance. They found that firm performance was positively associated with board independency, CEO/chairman position separation and with smaller boards. Duc and Thuy (2013) found that board compensation has a positive effect on performance measured by ROA and that the board size has a negative effect.

Globally, and specifically in smaller economies, applying governance framework is relatively a new trend and further evidence is needed to assess its impact. Khatab et al (2011) documented a strong evidence in line with the positive relation between firm performance and corporate governance mechanism for Karachi stock market. Al Haddad et al (2011) provide supporting evidence for a positive relation between governance application and profitability for Amman stock exchange; a MENA region market. For the Gulf Council Countries (GCC) market, Ahmed & Hamdan (2015) found a positive influence of corporate governance provisions on firm performance measured by return on assets and equity for Bahrain.

In less developed markets large publicly traded firms are generally closely held and their shares are held by controlling entrenched shareholders. Such dominating owners can expropriate minority shareholders (see for example, Shleifer & Vishny, 1997). La Porta et al (2000) believe that expropriation of minority shareholders by controlling shareholders can take many forms. Controlling shareholders can; steal the profits, divert business opportunities, appoint unqualified family members in key managerial positions and sell valuable assets of the firm they control to another firm they control at lower fair price. Hence, the above forms of expropriation of minority shareholders are consistent with the agency theory (see, for example, Jensen & Meckling, 1976).

Stronger market regulations that secure sound protection for investors signify developed markets. Following the 2008 global financial crisis, developing market and less developed markets are working hard to introduce new CG rules and regulations to protect investors from power abuse of the controlling managing minority. Regulators believe that well protected investors reduce agency cost, induce market growth, enhance firm value and that investors are willing to pay more for stocks of firms listed in such well-regulated, fair markets. They also believe

that creditors are more willing to finance firms when their rights are well protected by the legal system. However, a conclusive evidence of these believes is yet to be supported by scientific research.

For Kuwait stock exchange (**KSE**), there were two major sets of regulations that were introduced lately. The first was the **CMAL** to regulate the stock market in 2010. The second was the 2012 **KCL** or the ministry law (MLaw) to regulate shareholding companies. The new laws imposed many CG articles and provisions that forced all listed companies to make necessary changes in their bylaws and internal policies. We present, in the following section, a discussion of some of the articles included in the new law relevant to CG.

2.0 HYPOTHESES

2.1 KSE And The Reception of CAML:

KSE was officially established in 1983 following Almanakh stock market crisis, a major local financial crisis which started in 1981 and caused by severely inflated stock prices, unregulated market transactions and uncontrolled trading. Since official establishment, **KSE** has been regulated by a market committee headed by the Minister of Commerce with four representatives from the Chamber of Commerce and representatives from the Central Bank and Ministries of Commerce & Finance. A major structural change happened in 2010 when a new regulator took over market supervision from **KSE**. **CMAL** was issued in 2010 in an attempt to regulate Kuwait financial markets and to separate supervision from management roles. Up until the implementation of **CMAL**, Kuwait stock exchange played double role as a regulator and as an administrator of stock market trading which caused conflict of interest. However, following the 2008 global financial crisis and after the institution of capital market authorities in the entire GCC region, the need for an independent regulator in Kuwait has increased. The new regulatory body aimed to discipline the market through higher transparency requirements, protection of shareholders, governance rules, defining responsibilities, etc.

The new **CMAL** carried many new provisions with significant amount of legal burden on firms that were mostly recovering from the financial crisis. A major issue associated with the capital markets authority (CMA) is its budget and sources of operations finance. As mentioned in article 19, CMA shall finance its operations from market fees and violations fines. This provision increased the incentives for the regulator to increase costs, hence, the broad increase in market fees and accordingly an increase in market burden. This provision was lately amended to engage the government in financing CMA's budget in addition to market fees & fines. Another related issue associated with the **CMAL** was the separation of responsibilities between the stock exchange as a self-regulatory organization and the regulator. This separation was associated with a huge amount of overlapping in duties and ambiguity for market participants during the first years of CMA's launch. This element also increased the burden, on market participants and listed firms which led to a decrease of their activities in the market. Consequently, trading volume decreased significantly from an average KWD 148.9 million and 147.4 million in 2007 and 2008 respectively, to KWD 24.3 million and 28.9 million in 2011and 2012 respectively. The excessive fines and penalties and the number of legal cases filed against traders and market makers during the first 2 years of operations caused the market to freeze and all major players to stop trading.

According to article 63 of **CMAL**, all market participants shall receive a formal license from the CMA to participate in market activities including dealers, brokers, investment funds, etc. Licensing requirements were very strict and in some cases hard to obtain or applied. Accordingly, article 66 imposed a set of requirements all related to governance codes, such as separating activities, risk management, avoiding conflict of interest and reports requirements. Furthermore, articles from 71 to 75 setout shareholders provision protection for minorities. The law dealt also with provisions related to transparency and disclosure requirements. The last chapter of the law imposed market violation provisions which added strong enforcement factor to the market.

2.2 KCL Relevance to KSE:

The other law relevant to the operations of **KSE** is **KCL**. We counted 18 articles included in the new law that are related to issues of CG. Starting with article 181 and ending with article 216, these issues are summarized as follows:

1) Imposed minimum number of board members for public firms (article 181).
2) The positions of the chairman of the board and chief executive officer shall not be combined (article 183).
3) Regulatory bodies were given the right to impose the appropriate corporate governance code on firms under their jurisdiction, and thereby governance is mandated by law. Therefore, all public firms reacted to this article by changing their bylaws and internal policies (article 186).
4) Imposed presence of independent directors, at least one, and determined an upper cap of their number, surprisingly, not to exceed half of the board. Independent directors are exempted from the minimum ownership requirement (article 187).
5) Imposed a minimum number of 6 board meetings per year. This is in line with governance codes for having higher number of board meetings to keep the board well informed for an efficient decision making process (article 190).
6) A person, even if in the capacity of representative of a natural or legal person, may not be a member of the board of directors, of more than five Public Shareholders Companies headquartered in Kuwait (article 194).
7) Board members are not to exploit information to benefit selves or others, nor can they dispose shares they own in the company during tenure (article 195).
8) Board members are not allowed to disclose confidential information except through general assembly meetings (article196).
9) Board members of companies cannot serve in boards of two competing companies at the same time. This restriction is to prevent self-dealing, as well as to protect against conflict of interest; major elements in any proper corporate governance framework (article 197).
10) Remunerations for the board members shall not exceed 10% of net profit after dividends distribution of 5% for 5 years otherwise it should not exceed KD 6,000 annually for each member (article 198).
11) Board members, executive management and their families are banned from having interest in business deals with the company without the approval of the general assembly (article 199).
12) With the exception of banks and loan-extending companies, board members, CEO and families are not to receive loans from company without the approval of the general assembly (article 200).
13) Board members are legally responsible for fraud actions, misuse of authority and violation of this law.
14) Articles 206 and 208 call for fair general assembly meetings, sending invitations to all shareholders with proper agenda and complete set of information.
15) Articles 209, 212 and 216 provide minority shareholders the power to dismiss the board and the chairman when required.

The Kuwaiti public companies listed in the **KSE** have been complying with this law for about 5 years. Therefore, it is logical to hypothesize a positive effect of applying this law on all performance indicators of these companies.

To test for this effect, we discuss, in the following section, our data and methodology and measures to test specific hypotheses.

3.0 DATA AND METHODOLOGY

To study the effect of applying the new CG laws on the performance of the listed public companies, we need first to measure the significance of differences in performance indicators before and after the introduction of each law. If significant differences exist, then we measure the effect of introducing each law on each indicator. As **CMAL** was introduced in 2010 and the **KCL** was enforced during 2012. We collected fundamental data for the years 2007 to 2014 sourced from the annual published reports of the Institute of Banking Studies in Kuwait.

We elected the fundamental data of five sectors. We canceled out companies in other sectors which were unrepresentative of the nature of the sector to which they belong. For example, health care, communication and educational companies were included in one sector called services. The companies of each of the five sectors we chose were of the same nature. Originally, there were data for 147 companies. However, because of missing data for some of the years, some were canceled out. The number of companies remaining are 102 with 816 observations.

The data is organized in the form of long format of longitudinal data involving the dimensions of time and individual companies. The data is considered strongly balanced as each individual company have the same number of years.

Based on the reviewed literature, certain performance indicators were elected for investigation. These indicators represent profitability, valuation, assets management, debt and agency costs. The variables in question are profit multiplier, total assets turnover, debt ratio, return on equity and market to book ratio and equity to assets ratio. With these indicators, we presume to cover the most important performance aspects.

The following is a brief description of these indicators and the specific relevant hypotheses:

Total assets turnover is calculated as total revenue to total assets. This is an indicator of the company's efficiency in managing it assets. Higher numbers indicate better assets management efficiency. The hypothesis related to this indicator is that enforcing **CMAL** and **KCL**'s CG rules will prevent managers from investing in unnecessary assets leading to better assets turnover.

Debt ratio is the total debt to total assets. Although the ratio is important for measuring company financial distress, when it comes to cost efficiency, more debt leads to lower cost of capital and higher value. However, more increase of debt may lead to major financial distress or even bankruptcy. Our hypothesis, in relation to this indicator, is that enforcing **CMAL** and **KCL**'s CG rules will encourage managers to raising new external funds to finance viable investment leading to a higher debt ratio and better value.

Return on equity is a widely acceptable measure of profitability related to the owners' equity. It is calculated as the net profit to owners' equity. The logical hypothesis is that enforcing **CMAL** and **KCL**'s CG rules will ensure the alignment of the management interests with owners' interest leading to better profitability for the owners.

PE ratio is directly related to company valuation. We calculate it as closing price at the end of the year to earnings per share, which we estimate as net profit divided by number of shares outstanding. **PE** ratio is also called the profit multiplier. It indicates how much investors are willing to pay, profit multiples, to acquire the share. Higher **PE** ratio indicates higher value of the firm. Our hypothesis, in relation to this indicator, is that enforcing **CMAL** and **KCL**'s CG rules will lead to a higher **PE** hence a higher firm value.

MB ratio is also related to company valuation. It is calculated as the market stock price over book value per share (BVPS). BVPS divided is calculated as owners' equity over the number of shares outstanding. When **MB** is less than one, the company is seen as an opportunity for takeover. This is because owner's equity worth more than its market stock value.A buyer will be encouraged to sell it in pieces. On the other hand, a higher **MB** ratio indicates that investors are valuing the company higher than its equity. Our hypothesis, in relation to this indicator, is that enforcing **CMAL** and **KCL**'s CG rules will lead to a higher **MB** hence a higher firm value.

Agency cost is the money charged to the firm because of management misconduct. There are many proxies for agency costs measures. We choose the equity to total assets ratio for representation of agency costs as suggested by Berger and Patti (2006). They argue that higher leverage or lower equity to total assets is associated with lower agency costs. This is in line with our hypothesis on debt ratio. The hypothesis for this specific indicator is that enforcing **CMAL** and **KCL**'s CG rules will lead to a lower equity to total assets ratio leading to lower agency cost.

In this paper, we investigate

(1) The significance of differences in the performance indicators before and after the implementation of each law.

(2) The effect of each law on each performance indicator for the different sectors.

Here is a summary of our null against research hypotheses in relation to KCL:

Hypothesis 01

H0: Total assets turnover before and after the enforcement of **KCL**'s CG rules are same

H1: Total assets turnover before and after the enforcement of **KCL**'s CG rules are significantly different

Hypothesis 02

H0: Debt ratio before and after the enforcement of **KCL**'s CG rules are same

H1: Debt ratio before and after the enforcement of **KCL**'s CG rules are significantly different

Hypothesis 03

H0: Return on equity before and after the enforcement of **KCL**'s CG rules are same

H1: Return on equity before and after the enforcement of **KCL**'s CG rules are significantly different

Hypothesis 04

H0: **PE** ratio before and after the enforcement of **KCL**'s CG rules are same

H1: **PE** ratio before and after the enforcement of **KCL**'s CG rules are significantly different

Hypothesis 05

H0: **MB** ratio before and after the enforcement of **KCL**'s CG rules are same

H1: **MB** ratio before and after the enforcement of **KCL**'s CG rules are significantly different

Hypothesis 06

H0: Agency cost before and after the enforcement of **KCL**'s CG rules are same

H1: Agency cost before and after the enforcement of **KCL**'s CG rules are significantly different

In addition, the following is a summary of our null against hypotheses in relation to CMAL:

Hypothesis 07

H0: Total assets turnover before and after the enforcement of **CMAL**'s CG rules are same

H1: Total assets turnover before and after the enforcement of **CMAL**'s CG rules are significantly different

Hypothesis 08

H0: Debt ratio before and after the enforcement of **CMAL**'s CG rules are same

H1: Debt ratio before and after the enforcement of **CMAL**'s CG rules are significantly different

Hypothesis 09

H0: Return on equity before and after the enforcement of **CMAL**'s CG rules are same

H1: Return on equity before and after the enforcement of **CMAL**'s CG rules are significantly different

Hypothesis 10

H0: **PE** ratio before and after the enforcement of **CMAL**'s CG rules are same

H1: **PE** ratio before and after the enforcement of **CMAL**'s CG rules are significantly different

Hypothesis 11

H0: **MB** ratio before and after the enforcement of **CMAL**'s CG rules are same

H1: **MB** ratio before and after the enforcement of **CMAL**'s CG rules are significantly different

Hypothesis 12

H0: Agency cost before and after the enforcement of **CMAL**'s CG rules are same

H1: Agency cost before and after the enforcement of **CMAL**'s CG rules are significantly different

To test for significant differences in the performance indicators, we choose the nonparametric, mann-whitney U test. This is a two-independent-sample test procedure to compare two groups of cases on one variable. This test does not assume normality. It is considered more robust and more efficient than the student t-test as it is less likely to show statistical significance in the case of outliers' presence. Given the limited sample of this research, the mann-whitney U test is our best choice.

To investigate the effect of introducing the CG laws on performance, we use a generalized least square (GLS) model with panel data. We use a random effect model as we believe that the variation across companies and sectors is random and uncorrelated having some influence on the performance indicator variable.

Our GLS panel regression model is of the form:

$$Y_{it} = \beta_1 KCL_{it} + \beta_2 CMAL_{it} + \alpha + u_{it} + \varepsilon_{it} \text{ ..... (1)}$$

Where Y_{it} is the dependent variable representing the performance indicator. $_i$ is the entity and $_t$ is time. **KCL**$_{it}$ represents Kuwait company law binary variable, assigned 0 for the period before applying the law and 1 otherwise. **CMAL**it represents the capital market law binary variable, assigned 0 for the period before applying the law and 1 otherwise. β_1, β_2 and α are coefficients. u_{it} is the between-entity error and ε_{it} is the within-entity error.

Table 1 below presents a summary of the mean and standard deviation of the selected performance indicators before and after the introduction of **CMAL**. An interesting observation is the negative **ROE** for the banking sector. The mean was affected by the huge losses made by one of the banks in 2008. The Gulf Bank in Kuwait was the only bank in the GCC region to be rescued by a government as a result of the 2008 global financial crisis. The bank reported losses in excess of $1 billion

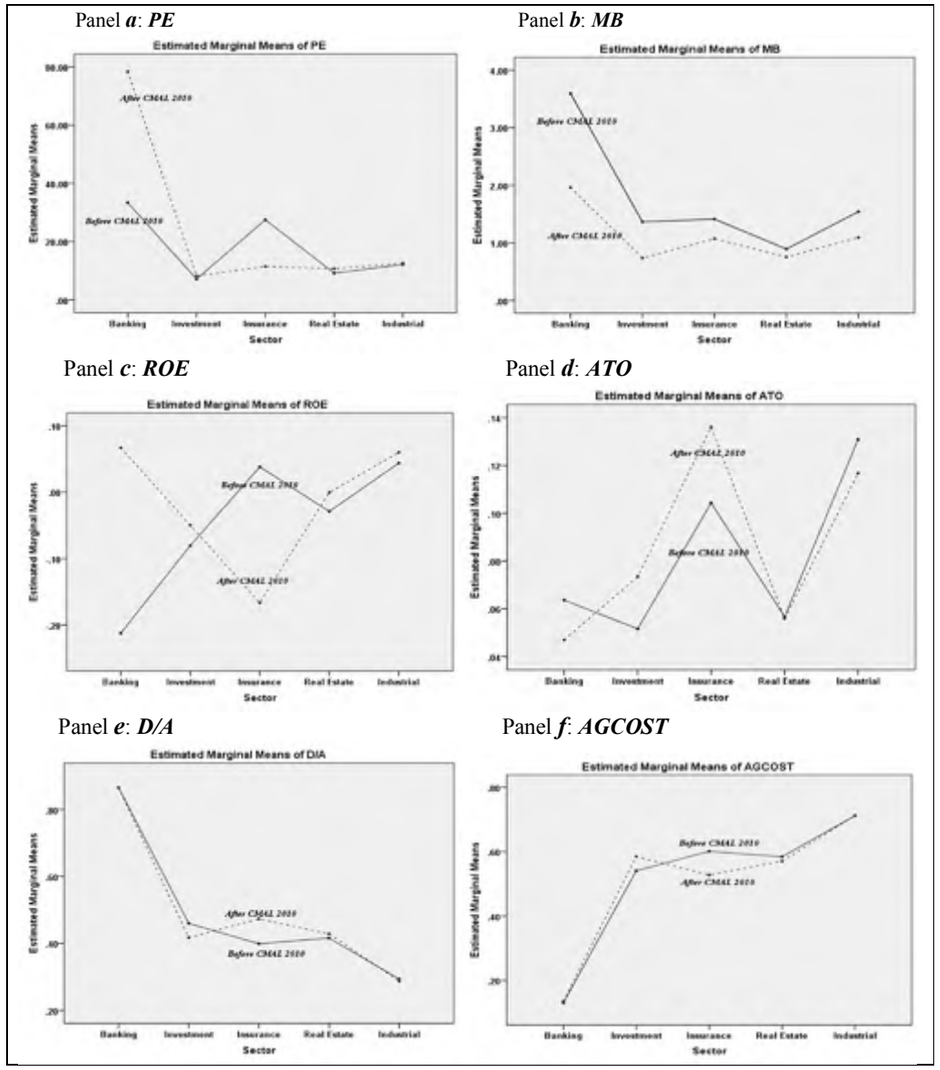
Table 1: Summary results of the mean and standard deviation before and after **CMAL**

		Sector	Mean	Std. Deviation		Mean	Std. Deviation
PE	Before CMAL	Banking	33.387	56.077	MB	3.593	5.225
		Investment	7.1411	35.738		1.364	.824
		Insurance	27.476	79.058		1.413	.828
		Real Estate	9.176	26.655		.893	.681
		Industrial	12.125	36.436		1.542	.746
	After CMAL	Banking	78.367	181.441		1.963	.941
		Investment	8.205	31.614		.738	.609
		Insurance	11.505	10.811		1.072	1.148
		Real Estate	10.696	24.001		.756	.659
		Industrial	12.590	27.816		1.094	.493
ROE	Before CMAL	Banking	-.212	1.693	D/A	.865	.041
		Investment	-.080	.405		.460	.240
		Insurance	.038	.144		.399	.228
		Real Estate	-.029	.204		.416	.183
		Industrial	.044	.200		.293	.209
	After CMAL	Banking	.067	.030		.865	.028
		Investment	-.050	.293		.418	.279
		Insurance	-.167	1.103		.473	.208
		Real Estate	-.001	.165		.429	.195
		Industrial	.060	.080		.287	.195
ATO	Before CMAL	Banking	.064	.013	AGCOST	.130	.0363
		Investment	.052	.150		.540	.2403
		Insurance	.104	.092		.601	.2278
		Real Estate	.057	.086		.584	.1831
		Industrial	.130	.099		.711	.2142
	After CMAL	Banking	.047	.008		.135	.0280
		Investment	.074	.113		.585	.2793
		Insurance	.136	.162		.528	.2094
		Real Estate	.056	.058		.570	.1946
		Industrial	.117	.065		.713	.1948

A noticeable lower standard deviation after the introduction of the capital market authority law, in almost all the performance indicators across the board (except for the banking sector), indicates the reduced risks in this period.

Figure 1 exhibits plots of the six performance indicators. Panel **a** shows a big increase in the valuation indicator represented by the **PE** ratio after applying **CMAL** reflecting the figures in table 1. Investment, real estate and industrial sectors indicated no noticeable change in the **PE** ratio. The insurance sector exhibits another noticeable change after the introduction of the law. This is understandable since insurance companies were expected to suffer more as a result of the crisis due the increased claims.

Figure 1: Plot of means before & After **CMAL**



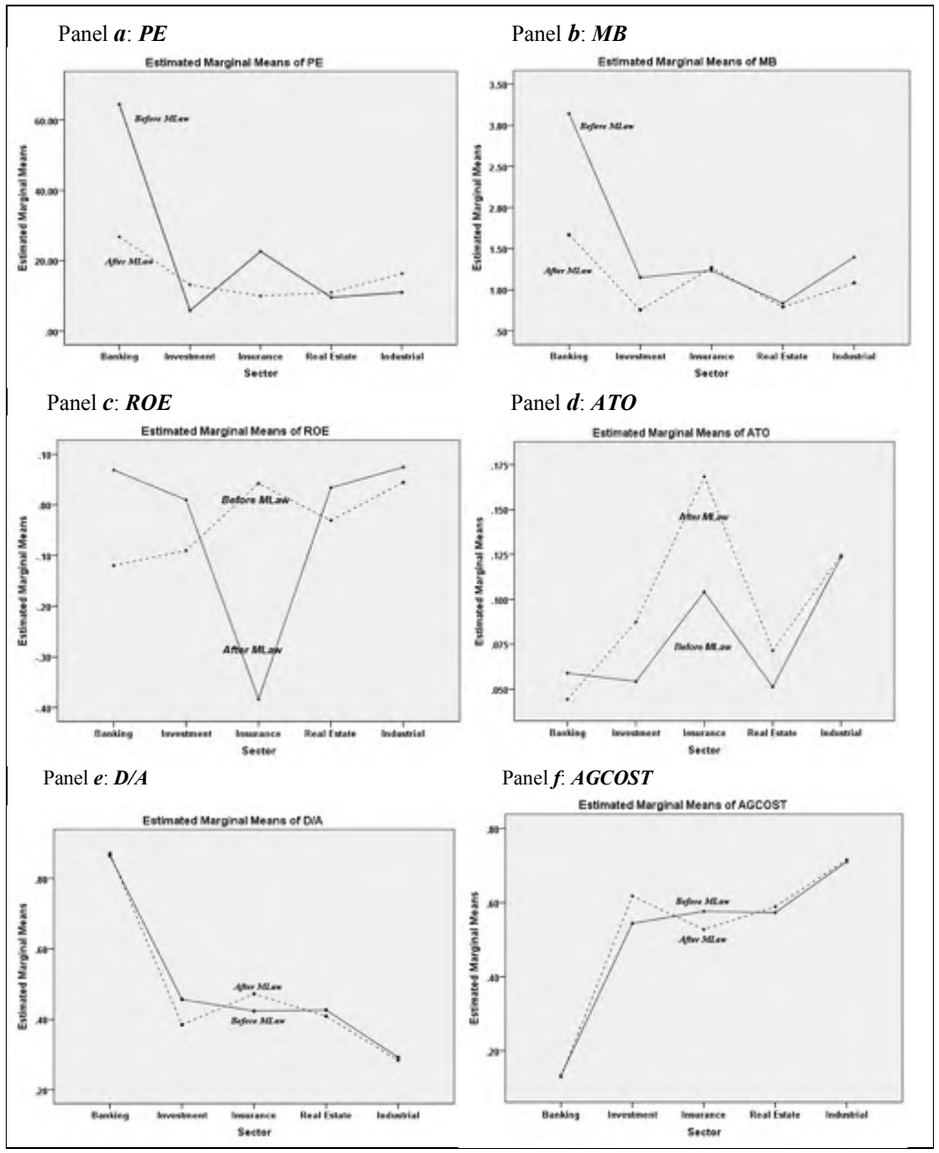
Panel **b** of figure 1 shows a decrease of value for all the sectors as indicated by the **MB** ratio. This is also understandable as equity decreased after 2008 across the board. The big losses of the banking sector as represented by the **ROE** ratio is evident in panel c. The same plot shows the big decrease of the ratio for the insurance sector after **CMAL**. Except for the banking and real estate sectors, the asset management as represented by the **ATO** ratio has improved after **CMAL**. Panels **e** and **f** exhibit unnoticeable change in the debt ratio and agency cost ratio.

Table 2 below presents a summary of the mean and standard deviation of the selected performance indicators before and after the introduction of **KCL**. The negative **ROE** for the banking sector is smaller compared to the one in table 1. The reason for that is including more years in the before-**KCL** period with positive results due to the government rescue of $1.4 billion for the Gulf bank. The negative **ROE** before **KCL** results for banking, investment and real estate sector may be a direct result of the global financial crisis in 2008.

Table 2: Summary results of the mean and standard deviation before and after KCL

		Sector	Mean	Std. Deviation		Mean	Std. Deviation
PE	Before KCL	Banking	64.4919	152.75552	MB	3.1417	4.33674
		Investment	5.8442	33.24522		1.1500	.78938
		Insurance	22.6496	64.98649		1.2340	.74806
		Real Estate	9.5881	27.01401		.8360	.70746
		Industrial	11.0221	32.35847		1.3960	.70983
	After KCL	Banking	26.8107	16.96063		1.6686	.64413
		Investment	13.1603	34.62610		.7552	.71141
		Insurance	10.0140	7.08740		1.2686	1.58722
		Real Estate	10.9820	19.53665		.7907	.55702
		Industrial	16.3622	32.24901		1.0843	.46164
ROE	Before KCL	Banking	-.1198	1.38280	D/A	.8637	.03782
		Investment	-.0902	.39467		.4564	.25857
		Insurance	.0421	.12343		.4239	.21653
		Real Estate	-.0308	.19555		.4267	.18693
		Industrial	.0443	.17313		.2924	.20730
	After KCL	Banking	.0687	.01600		.8704	.02391
		Investment	.0097	.15787		.3849	.26082
		Insurance	-.3837	1.55193		.4723	.23208
		Real Estate	.0335	.14119		.4090	.19522
		Industrial	.0743	.05251		.2842	.18550
ATO	Before KCL	Banking	.0589	.01324	AGCOST	.1329	.03477
		Investment	.0543	.13671		.5442	.25896
		Insurance	.1041	.07982		.5766	.21724
		Real Estate	.0513	.07703		.5733	.18691
		Industrial	.1236	.09057		.7108	.21069
	After KCL	Banking	.0443	.00797		.1296	.02391
		Investment	.0874	.11770		.6179	.26118
		Insurance	.1683	.22301		.5277	.23209
		Real Estate	.0715	.05718		.5892	.19470
		Industrial	.1245	.06020		.7158	.18549

Figure 2 below exhibits plots of means for the six performance indicators before and after applying KCL. The banking sector in panel a shows the negative ROE as explained earlier.



In panel **c**, we can observe the big plunge of **ROE** for the insurance sector after applying the law. This huge drop in profitability can only be explained in the context of the 2008 global financial crisis. In general the plots show a general drop in valuation and profitability and an increase in agency cost due to the same reason.

4.0 TESTING RESEARCH HYPOTHESES

Table 3a below presents the results of the Mann-Whitney two-independent-sample test to compare two groups of cases on each performance variable using **CMAL** binary as the grouping variable for each of the five sectors in **KSE**.

Table 3a: Mann-Whitney U test with **CMAL** grouping

		PE	MB	ROE	D/A	ATO	AGCOST
Sector 1: Banking	Mann-W.U	348.00	292.00	382.00	497.00	131.00	487.00
	Wilcoxon	876.00	820.00	910.00	1025.00	627.00	1015.00
	Z	-2.202	-2.954	-1.746	-.201	-5.018	-.336
	Asymp. Sig.	.028*	.003*	.081**	.840	.000**	.737
Sector 2: Investment	Mann-W.U	8027.50	3541.00	8509.50	7871.50	8571.50	7821.50
	Wilcoxon	16805.50	12319.00	17287.50	16649.50	17349.50	16599.50
	Z	-1.104	-8.336	-.326	-1.355	-.227	-1.436
	Asymp. Sig.	.270	.000*	.744	.175	.821	.151
Sector 3: Insurance	Mann-W.U	390.00	233.000	384.00	313.00	376.00	314.00
	Wilcoxon	796.00	639.000	790.00	719.00	782.00	720.00
	Z	-.033	-2.606	-.131	-1.295	-.262	-1.278
	Asymp. Sig.	.974	.009*	.896	.195	.793	.201
Sector 4: Real Estate	Mann-W.U	6594.50	5715.00	6929.00	7033.00	6913.00	7011.00
	Wilcoxon	13854.50	12975.00	14189.00	14293.00	14173.00	14271.00
	Z	-1.126	-2.761	-.504	-.311	-.534	-.351
	Asymp. Sig.	.260	.006*	.614	.756	.594	.725
Sector 5: Industrial	Mann-W.U	4601.00	2916.00	4379.00	4587.00	4338.50	4525.50
	Wilcoxon	9257.00	7572.00	9035.00	9243.00	8994.50	9181.50
	Z	-.018	-4.395	-.595	-.055	-.700	-.214
	Asymp. Sig.	.985	.000*	.552	.957	.484	.830

* Statistically significant @ 5%
** Statistically significant @ 10%

The results indicate that for the banking sector **PE** and **MB** are significant at the 5% level and **ROE** and **ATO** are statistically significant at the 10% level. This means that valuation, profitability and asset management performance indicators before and after the introduction of the **CMAL** are statistically different in the banking sector. For the other four sectors, only **MB** is statistically significant at the 5%. This means that the value performance indicator before and after applying the law is statistically different.

Table 3b shows the results of the Mann-Whitney two-independent-sample test to compare two groups of cases on each performance variable using **KCL** binary as the grouping variable.

Table 3b: Mann-Whitney U test with **KCL** grouping

		PE	MB	ROE	D/A	ATO	AGCOST
Sector 1: Banking	Mann-W.U	339.00	196.00	330.00	321.00	110.00	337.00
	Wilcoxon	1515.00	332.00	466.00	1497.00	230.00	473.00
	Z	-.69	-2.92	-.84	-.98	-4.03	-.729
	Asymp. Sig.	.485	.004*	.40	.329	.000*	.46
Sector 2: Investment	Mann-W.U	5356.00	3879.00	5189.00	5584.00	5678.00	5548.00
	Wilcoxon	25057.00	6090.00	24890.00	7795.00	25379.00	25249.0
	Z	-2.19	-4.94	-2.50	-1.77	-1.59	-1.83
	Asymp. Sig.	.028*	.000*	.012*	.077**	.110	.060**
Sector 3: Insurance	Mann-W.U	282.00	214.00	278.00	248.00	274.00	248.00
	Wilcoxon	387.00	319.00	383.00	1151.00	1177.00	353.00
	Z	-.23	-1.51	-.30	-.87	-.38	-.87
	Asymp. Sig.	.820	.130	.762	.380	.710	.380
Sector 4: Real Estate	Mann-W.U	4448.00	5342.00	4078.00	5024.00	4689.00	5057.00
	Wilcoxon	20738.00	21632.00	20368.00	6854.00	20979.00	21347.00
	Z	-2.04	-.13	-2.84	-.81	-1.53	-.73
	Asymp. Sig.	.041*	.90	.005*	.420	.130	.460
Sector 5: Industrial	Mann-W.U	3265.00	2615.00	3283.00	3450.00	3299.00	3434.00
	Wilcoxon	13705.00	3791.00	13723.00	4626.00	13739.00	4610.00
	Z	-.57	-2.52	-.52	-.02	-.47	-.06
	Asymp. Sig.	.567	.012*	.604	.99	.63	.94

* Statistically significant @ 5%
** Statistically significant @ 10%

Table 3b shows that only **PE** and **ATO** indicators are statistically significant at the 5% level for the banking sector. That is the value and asset management performance indicators for the banking sector before and after the introduction of the **KCL** are statistically different. For the investment sector, however, all performance indicators except **ATO** are statistically different. The results also indicate that none of the performance indicators is statistically different for the insurance sector. For the real estate sector only **PE** and **ROE** are statistically different at the 5% significant level indicating differences in valuation and profitability before and after the introduction of the law. For the industrial sector, only **MB** is significant at the 5% level which indicates differences in valuation of this sector before and after the introduction of the law.

Tables 4 and 5 below summarize the results of hypotheses testing based on the introduction of **KCL** and **CMAL**.

Table 4: Summary of hypotheses testing results based on **KCL**

Hyp. No	Null hypothesis (H_0)	Sector	Result @ 5%
1	ATO before and after the enforcement of KCL's CG rules are same	Banking	Reject
		Investment	
		Insurance	
		Real estate	
		Industrial	
2	Debt ratio before and after the enforcement of KCL's CG rules are same	Banking	
		Investment	Reject @ 10%
		Insurance	
		Real estate	
		Industrial	
3	ROE before and after the enforcement of KCL's CG rules are same	Banking	
		Investment	Reject
		Insurance	
		Real estate	Reject
		Industrial	
4	PE ratio before and after the enforcement of KCL's CG rules are same	Banking	
		Investment	Reject
		Insurance	
		Real estate	Reject
		Industrial	
5	MB ratio before and after the enforcement of KCL's CG rules are same	Banking	Reject
		Investment	Reject
		Insurance	
		Real estate	
		Industrial	Reject
6	Agency cost before and after the enforcement of KCL's CG rules are same	Banking	
		Investment	Reject @ 10%
		Insurance	
		Real estate	
		Industrial	

Table 5: Summary of hypotheses testing results based on **CMAL**

7	ATO before and after the enforcement of CMAL's CG rules are same	Banking	Reject @ 10%
		Investment	
		Insurance	
		Real estate	
		Industrial	
8	Debt ratio before and after the enforcement of CMAL's CG rules are same	Banking	
		Investment	
		Insurance	
		Real estate	
		Industrial	
9	ROE before and after the enforcement of CMAL's CG rules are same	Banking	Reject @ 10%
		Investment	
		Insurance	
		Real estate	
		Industrial	
10	PE ratio before and after the enforcement of CMAL's CG rules are same	Banking	Reject
		Investment	
		Insurance	
		Real estate	
		Industrial	
11	MB ratio before and after the enforcement of CMAL's CG rules are same	Banking	Reject
		Investment	Reject
		Insurance	Reject
		Real estate	Reject
		Industrial	Reject
12	Agency cost before and after the enforcement of CMAL's CG rules are same	Banking	
		Investment	
		Insurance	
		Real estate	

4.1 Estimating The GLS Panel Data Regressions:

Autocorrelation, heteroskedasticity, stationarity and independent variables' multi-co-linearity are all common problems with linear regressions. Given the nature of our panel data, autocorrelation and heteroskedasticity are not a concern since we consider only a total of eight years for all the companies. This number is further split when grouping to compare performance indicators. We also use the option of robust standard error to eliminate these two problems. The problem of multi-co-linearity of explanatory variables is not a concern either since we use binary variable representing different time groupings.

To test for stationarity in the series property of the dependent variable, we use the Levin-Lin-Chu unit root. The null hypothesis of this test is that panels contain unit roots against the alternate hypothesis that panels are stationary. The results of this test are presented in table 6 below.

Table 6: Results of unit root test of stationarity

Performance Indicator	Statistic	p-value	Status
PE	-84.4800	0.0000	stationary
MB	-43.8726	0.0000	stationary
ROE	-1.3e+04	0.0000	stationary
D/A	-13.8402	0.0000	stationary
AGCOST	-23.6522	0.0000	stationary
ATO	-37.5514	0.0000	stationary

Table 6 indicates that all variables do not contain unit root and are stationary. Therefore, we can conclude that a linear model can be estimated safely.

Our GLS equation with panel data was estimated thirty times to cover the six performance indicators (dependent variables) for each of the five sectors. Table 7 illustrates the results of the model estimation.

Table 7: GLS panel data regression for the banking sector

			Robust Coef.	Std. Err.	z	P>z
Sector 1: Banking	PE	KCL	-99.73687	90.60872	-1.10	0.271
		CMAL	93.31562	93.62209	1.00	0.319
	MB	KCL	-.505625	.229312	-2.20	0.027*
		CMAL	-1.354375	.7661719	-1.77	0.077**
	ROE	KCL	.006875	.0121062	0.57	0.570
		CMAL	.2775	.3054182	0.91	0.364
	DtoA	KCL	.01125	.0066356	1.70	0.090**
		CMAL	-.0053125	.0128605	-0.41	0.680
	AGCOST	KCL	-.0110331	.0058373	-1.89	0.059**
		CMAL	.0101931	.0088869	1.15	0.251
	ATO	KCL	-.0057344	.0019104	-3.00	0.003*
		CMAL	-.0141621	.0015892	-8.91	0.000*

* Statistically significant @ 5%
** Statistically significant @ 10%

As indicated by table 7, four performance indicators are found to be statistically significant either at the 5% level or at the 10% level of significance. These indicators are market to book value representing the value of the firm, debt to asset ratio representing financial leverage, AGCOST representing additional expenses as a result of agency problems and total assets turn over representing the efficiency of asset management.

Market to book value indicator is affected negatively by the introduction of both laws indicating a decrease in valuation of banks. This result can be interpreted by the fact that inappropriate laws or heavy legal burden and sometimes unneeded, governance may lead to damaging outcomes. This argument is particularly true in the case of Kuwait. Major controversial and prolonged discussions and amendments to both laws took place before and after approval. One of the authors of this paper was a minister of trade at that time and was deeply involved in preparing the original draft of the laws. She witnessed an immense resistance and pressure by external powers to affect government and parliament to amend the laws to serve their interests. Many market participants believe that corporate governance objectives of the two laws cannot be achieved.

Financial leverage factor was found to be affected positively by the introduction of **KCL** only. The positive effect on leverage could mean that banks feel safe to increase their financial leverage/risk with the introduction of corporate governance rules included in the new companies' law. The agency cost variable represented by the ratio of equity to total assets is also found to be positively affected by the **KCL** indicating lower agency cost. This is in line with resulting effect on financial leverage.

KCL is also found to affect the asset turn over variable negatively. This means that the performance of the banking sector may be worse with the introduction of both laws in terms of asset management. The result confirms the argument we made with regard to the negative outcome of the value performance indicator.

The results of estimating the **GLS** regressions for the investment sector is presented below in table 8. It shows that all performance indicators were affected.

Table 8: **GLS** panel data regression for the investment sector

			Robust Coef.	Std. Err.	z	P>z
Sector 2: Investment	PE	KCL	9.910303	4.843474	2.05	0.041*
		CMAL	-3.891439	4.712117	-0.83	0.409
	MB	KCL	.0337879	.114125	0.30	0.767
		CMAL	-.6419697	.0966353	-6.64	0.000*
	ROE	KCL	.119697	.0621403	1.93	0.054**
		CMAL	-.0285606	.0549637	-0.52	0.603
	DtoA	KCL	-.0654545	.0226634	-2.89	0.004*
		CMAL	-.0099242	.0252863	-0.39	0.695
	AGCOST	KCL	.0661216	.0246716	2.68	0.007*
		CMAL	.0114057	.0257037	0.44	0.657
	ATO	KCL	.0278666	.0168081	1.66	0.097**
		CMAL	.0079253	.0131243	0.60	0.546

* Statistically significant @ 5%
** Statistically significant @ 10%

Table 8 indicates that **PE** is affected positively by **KCL**. The **PE** ratio reflects, particularly, the trader's market valuation of the firm stock. Our interpretation of this result is that stock traders may have believed that the implementation of the **KCL** will positively affect the performance of the investment sector following the 2008 crisis influencing their optimistic decisions.

Contrary to the resulting positive effect on **PE** ratio, market to book value ratio is found to be negatively influenced by **CMAL**. This is another valuation indicator reflecting value based on the firm's actual equity. This result tells us that the value of the firm, based on its equity, deteriorate as a direct result of implementing the capital market authority law. **MB** ratio is also driven by traders' perception of the future of the firm. The negative effect may be interpreted by the fact that traders believe **CMAL** is unable to improve firm valuation especially as the investment sector was hit badly with huge provisions following the 2008 global financial crisis.

Return on equity indicator is positively affected by **KCL**. An increase of **ROE** may be due to a decrease in equity of the investment sector relative to profit improvement. The result tells us that the investment sector receive the implementation of **KCL** as a driver of profitability.

Furthermore, the leverage performance indicator is negatively influenced by **KCL**. This means decision makers in the investment sector may not feel safe with implementation of **KCL** to raise external funding which associated with financial risk. Again, the aftermath of the global financial crisis may add more weight to this feeling.

Also, **KCL** has a positive influence on the AGCOST variable indicating lowered agency cost. Contrary to the same variable for the banking sector, this result means that the implementation of **KCL** does lead to an improvement in the agency cost of the investment sector. This is understandable since it is the sector that suffered the most from the financial crisis.

Assets turnover representing the asset-management performance indicator of the sector is also found positively inspired by the implementation of **KCL**.

Table 9 depicts the resulting outcome of estimating our **GLS** model for the insurance sector. It shows a significant effect of **CMAL** on market to book value financial leverage and assets turnover. **KCL** has no significant effect on any of the financial indicators.

Table 9: **GLS** panel data regression for the insurance sector

			Robust Coef.	Std. Err.	z	P>z
Sector 3: Insurance	PE	KCL	-2.984286	4.61477	-0.65	0.518
		CMAL	-14.47821	20.52137	-0.71	0.480
	MB	KCL	.3921429	.455595	0.86	0.389
		CMAL	-.5346429	.2661795	-2.01	0.045*
	ROE	KCL	-.4342857	.4466767	-0.97	0.331
		CMAL	.0128571	.0289223	0.44	0.657
	D/A	KCL	-.0014286	.030148	-0.05	0.962
		CMAL	.0753571	.0381258	1.98	0.048*
	AGCOST	KCL	-2.984286	4.61477	-0.65	0.518
		CMAL	-14.47821	20.52137	-0.71	0.480
	ATO	KCL	.3921429	.455595	0.86	0.389
		CMAL	-.5346429	.2661795	-2.01	0.045*

* Statistically significant @ 5%

The effect on market to book value ratio is negative, indicating a pessimistic market perception with regard to the effectiveness of the **CMAL** to improve firm value within the insurance sector. The same applies to the asset management variable. On the other hand, financial leverage is positively affected demonstrating an optimistic reception of the implementation of the **CMAL** with regard to raising new external funds.

The results of the regression model for the real estate sector is illustrated in table 10 below. It shows that except for the **PE** ratio, all the variables are significantly influenced.

Table 10: **GLS** panel data regression for the real estate sector

			Robust Coef.	Std. Err.	z	P>z
Sector 4: Real estate	PE	KCL	.5716667	3.044622	0.19	0.851
		CMAL	1.2335	4.429524	0.28	0.781
	MB	KCL	.0695	.0802247	0.87	0.386
		CMAL	-.1725833	.0830032	-2.08	0.038*
	ROE	KCL	.0678333	.0206655	3.28	0.001*
		CMAL	-.0056667	.0294819	-0.19	0.848
	D/A	KCL	-.0386667	.022559	-1.71	0.087**
		CMAL	.0316667	.020544	1.54	0.123
	AGCOST	KCL	.0376576	.0226317	1.66	0.096**
		CMAL	-.0326681	.0205294	-1.59	0.112
	ATO	KCL	.0310313	.0088609	3.50	0.000*
		CMAL	-.0162455	.0085975	-1.89	0.059**

* Statistically significant @ 5%
** Statistically significant @ 10%

CMAL has a negative effect on **MB** of the real estate sector indicating a lower valuation following the implementation of the capital markets authority law. As mentioned earlier, this kind of valuation is based on market perception of the effectiveness of the new law as a driver of firm value.

Return on equity indicator, on the other hand, is positively affected by **KCL**. This is in line with the objectives of the law. Another objective is lowering agency costs. This is confirmed by the positive effect of **KCL** on the AGCOST variable which is positively significant. The leverage ratio, however, is indicating a negative influence. Again, for decision makers in this sector, the implementation of the new **KCL** does not encourage external funding.

Also, the assets turnover variable is positively affected by **KCL** and negatively affected by **CMAL**. This implies that **KCL** implementation leads to better assets management in the real estate sector and the implementation of the **CMAL** leads to worse assets management. The contradicting sign of the statistic may be explained by the

different natures of the laws. The **KCL** is concerned mainly with factors related to the internal operation of the company. The CAML is concerned with companies listed in the stock market. The main objective of the later is the fair dealing of the company stocks.

The results of estimating the **GLS** model for the industrial sector is illustrated by table 11. **PE**, **MB ROE** and **ATO** are the variables exhibiting significant effect.

Table 11: **GLS** panel data regression for the industrial sector

			Robust Coef.	Std. Err.	z	P>z
Sector 5: Industrial	PE	KCL	7.546042	4.340131	1.74	0.082**
		CMAL	-3.308646	4.207602	-0.79	0.432
	MB	KCL	-.0208333	.0857809	-0.24	0.808
		CMAL	-.4373958	.0990324	-4.42	0.000*
	ROE	KCL	.0291667	.0149837	1.95	0.052**
		CMAL	.0014583	.0220163	0.07	0.947
	D/A	KCL	-.00625	.0173942	-0.36	0.719
		CMAL	-.0027083	.0124018	-0.22	0.827
	AGCOST	KCL	.0061996	.0172693	0.36	0.720
		CMAL	-.0018171	.0139378	-0.13	0.896
	ATO	KCL	.0154464	.0079266	1.95	0.051**
		CMAL	-.0218075	.011798	-1.85	0.065**

* Statistically significant @ 5%
** Statistically significant @ 10%

The effect of **KCL** on **PE** is positive. The effect on this valuation indicator means that the market gives more value to the industrial sector in response to the new corporate governance rules included in the law. Another valuation indicator represented by the market to book value was found to be affected negatively the CAML. It indicates the market is encouraged by the introduction of the new governance rules included in the **CMAL** law. **KCL**, on the other hand, was found to have a positive effect on the profitability performance of this sector. This shows that corporate governance rules included in the **KCL** leads to an improvement of profitability for industrial companies. Although the effect of **KCL** is positive on **ATO** variable, the negative effect of the **CMAL** is evident again on the assets turnover indicator.

An important finding of this research is that, except for D/A ratio, all performance indicators were negatively affected by **CMAL**. This is evident in table 12 which presents a summary of the resulting signs of all significant effect. The other major finding is that most of the performance indicators that were significantly affected by **KCL** had positive coefficients. The only explanation of these two contradicting results is that, unlike **KCL**, **CMAL** has included corporate governance rules that are inappropriate or ineffective in improving the performance of the Kuwaiti companies. Intolerable strict and heavy CG regulations are common pitfalls of incompetent regulators. This is in line with conclusions made by Carney (2006) and Bruno & Claessens (2010).

Table 12: A summary of the resulting signs of all significant effects

			Banking	Investment	Insurance	R Estate	Industrial
Performance Indicators	PE	KCL		+			+
		CMAL					
	MB	KCL	-				
		CMAL	-	-	-	-	-
	ROE	KCL				+	+
		CMAL					
	D/A	KCL	+	+		-	
		CMAL			+		
	AGCOST	KCL	+	+		+	
		CMAL					
	ATO	KCL	-	+		+	+
		CMAL	-		-	-	-

CONCLUSION

Following the 2008 global financial crisis many countries all over the world have enforced new market reforms and more strict corporate governance regulations. Kuwait was not an exception. It enforced two major laws targeting market reforms and improvement of corporate governance of the companies listed in Kuwait stock exchange. The capital market authority law (**CMAL**) was implemented in 2010 and the Kuwait companies' law (**KCL**) was implemented in 2012. Feasibility of the two laws was controversial as it was extensively debated among economic and political rivals. Eventually the two laws were enforced.

In this research, we sought answers to two question (1) has the performance of the listed companies changed in response to the enforcement of the two laws? And (2) if it has, was there a direct influence of the laws on that change?

To answer the questions, we reviewed the relevant literature with the objective of identifying the proper factors to measure and develop our research hypotheses. Six factors were identified representing valuation, profitability, assets management, debt and agency costs. For each factor we developed two hypotheses for a total of twelve hypotheses. Each hypothesis is tested using mann-whitney U test of two-independent-sample to compare two groups of cases. For the **CMAL**, except for the agency cost indicator, all

indicators for the banking, before and after the implementation of the law were found to be significantly different. For the other sectors, only the valuation factor represented by the market to book value was found to be significantly different. For the **KCL**, market to book value and assets management factor were found to be significantly different for the banking sector. For the investment sector, except for assets management factor, all other factor were found to be significantly different. Performance indicators for the insurance sector exhibited no significant differences. Profitability indicator and valuation indicator, represented by the price earnings ratio for the real estate sector, before and after the implementation of **KCL**, were significantly different. Valuation indicator represented by the market to book value ratio was the only factor to exhibit a significant difference. These results are definitely inconclusive.

The outcomes of **GLS** panel data regressions for each of the law were also inconclusive. Some of the indicators were found to be influenced by the implementation of the two laws and some were not. However, two important results were interesting and require further investigation. The first is that **KCL** is more feasible in enhancing performance indicators than **CMAL**. In fact, all the performance indicators that were found to be influenced by **CMAL** had negative coefficients indicating lower performance. This might be an evidence of how harmful stringent reforms to firm performance.

Based on these findings, we recommend that regulators in Kuwait should review the current version of **CMAL** and amend it according to the best standards. Our results, definitely, suggest that the capital market authority law was not received positively by the Kuwaiti market.

This study should be revisited by including more companies, time series and sectors in the future. Our results were based on fundamental data of the listed companies. Soliciting opinions of all stakeholders of the **CMAL**, in particular, may be crucial for a more general conclusion. This is what the authors intend to do in a separate survey study.

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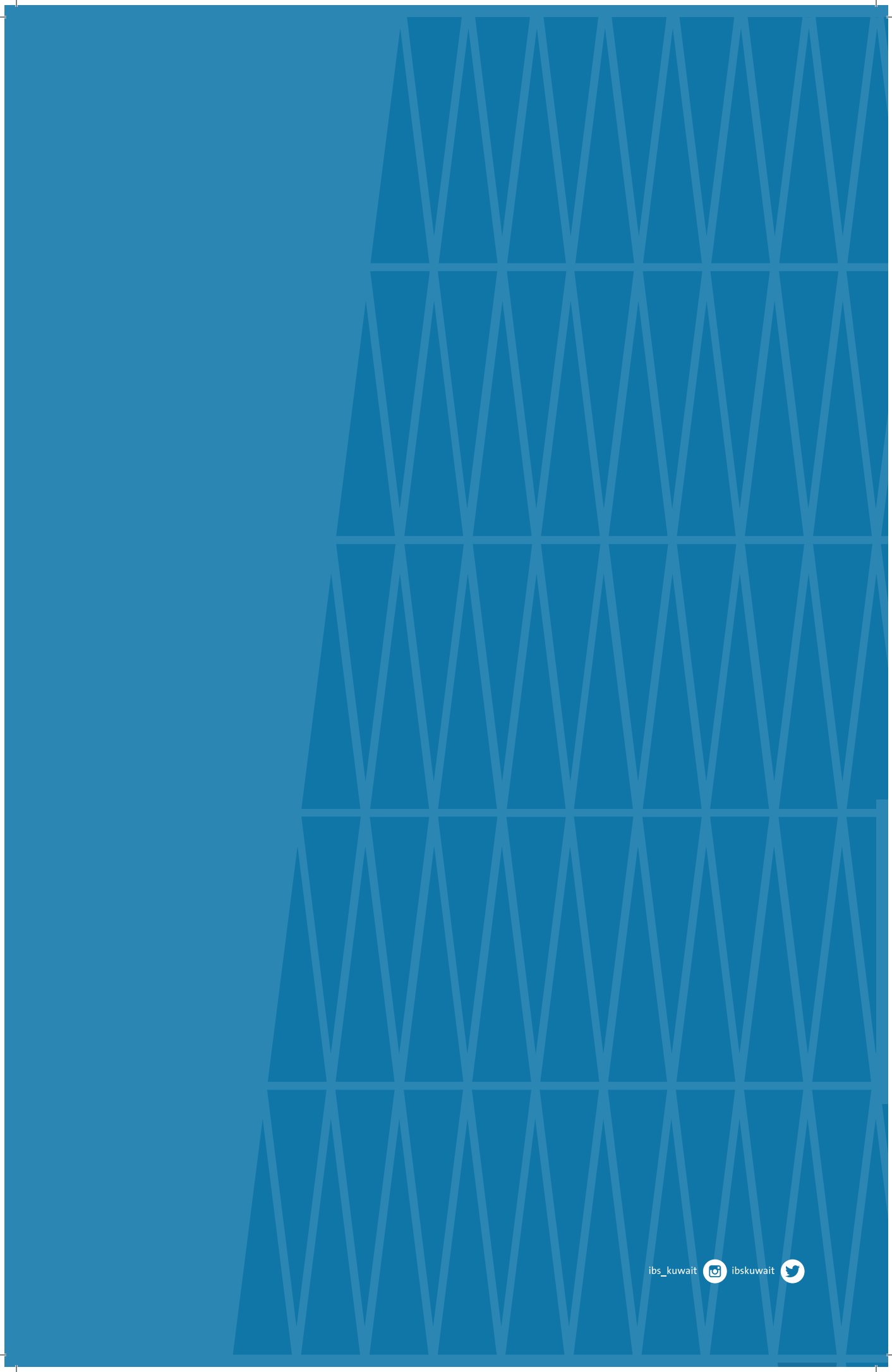
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