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Corporate Governance: Banking Sector and Economic Development

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Abstract: Corporate governance is concerned as the most important topic to be discussed by financial entities and economic institutions in developed and transition economic countries during the last decade especially several financial crisis took places around the world especially, the ninetieth was full of crises and scandals that highlighted the low quality of monitoring and related weak accounting system beside the poor experience and transparency. These crises and scandals made many shareholders and citizens to lose their wealth and due to that shareholders and citizens look for corporations applying corporate governance. Besides that, developed economic countries employ governance mechanisms aggressively in order to increase the investment possibilities in their corporations and territories. Overall, corporate governance has its role in economic reformation and economic development.

Keywords: Corporate Governance, Economic Development, Banking Sector, High Quality Performance.
JEL Classification: M4, M2, M11

1. Introduction

Corporate governance is a comprehensive and important term has been widely discussed in the two decades, and that includes developed and transition economy countries. That is due to a fact that corporate governance is related to accountancy, management, financial, social and environmental perspectives. Even so, there is no a specific definition of corporate governance, all these definitions concern about rules and regulations organize the relationship among stakeholders; owners, shareholders, managers, citizens....etc, in order to increase the profitability of companies. Although, corporate governance is considered as a set of motivations to increase the profit volume for shareholders in the meanwhile monitoring system over financial and none financial activities is applied. Corporate governance allows shareholders to issue a board of directors to manage and control the activities of their companies. In the light of that, corporate governance assures transparency and accountability beside independence of executives and directors. Applying corporate governance ensures the integrity of the relationship between investors and companies through financial controlling and voting right, even that costs companies, but it brings more benefits over activities and results of these companies. The efficient applying of corporate governance is based on legalizations in the states and others codes related to the investment environment and competition level besides the quality of financial sector, also, the internal rules' procedures and responsibility distribution affect strongly on corporate governance.

In accordance with that, corporate governance is more adapted than legal structure, thus it is defined by Weimer and Pape in 1999;"*Country specific framework of legal, institutional and cultural factors, shaping the patterns of influence that stakeholders exert on managerial decision-making*", furthermore, Charreaux defined corporate governance in 1997 by "*all the organizational mechanisms which have the effect of bounding the powers and of influencing the decisions of managers, in other words, the mechanisms which 'govern' their behavior and define their discretionary space*", with the factors integration of the global economy compels corporate governance to be both applied harmonize. Besides that, trust and confidence are important function keys of a global market economy. Regaining the missed trust of investors by employing corporate governance is a good way for economic growth after several financial scandals hit the global economy. In the light of that, Andrade and Rossetti in 2004 identified three drivers that are the core stone of the leverage economic growth as the following: trustworthy and stimulant institutions, good macroeconomic fundamentals and competitive availability. In 2003, Babic added corporate governance for the previous three drivers since he ensured the positive impacts of corporate governance on economic growth.

2. Banking Governance

Due to the quick development in the capital and financial markets besides the aggressive adapting of information technology and high competition among banks, corporate governance represents an important issue that is protecting shareholders and depositors besides monitoring the performance of the board of directors. That request a need for applying corporate governance in public and private banks. In the light of that, banking governance concerns on two separated groups; first group (internal stakeholders) presented by shareholders, board of directors, executive committee and internal auditors, and the second groups (external stakeholders); depositors, the deposit insurance fund, advertising, classification and valuation investments companies besides states laws concerned with monitoring and legitimacy issues.

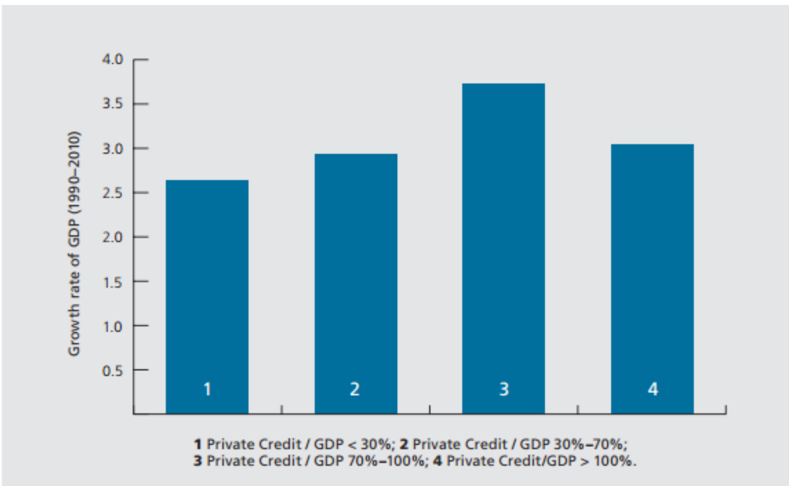
In 1999, the Basel Committee issued a report on the role of corporate governance in the banking sector and later in 2006 issued a new report focused on the independence and qualifications of executives and directors, since they assure banking performance quality and they determine the strategies and make investment decisions. In addition, the board of directors should monitor and manage the bank's strategic objectives and prepare periodical reports on unlawful and unmoral performances, also, the board should define a comprehensive management structure that encourages accountancy and determine the responsibilities of executives. The report ensures highly a need for qualified and independent directors, executives, and auditors since they are the core stones of governance body. The impacts of employing corporate governance in the banking sector are represented throughout increasing the investment opportunities, low investment cost and encouraging the state to keep the stability of the financial market besides fighting corruption. In addition and as a result, transparency and independence are assured in the financial performance of banks. In other hand, banks strengthen corporate governance application since they are an essential fund resource for corporations which look for profitability. Due to the perspective of banks is based on a fact that banks are shareholder corporations apply corporate governance to reduce the risk volume, besides that, strengthening the best practices of corporate governance in banks is led by central banks since they are responsible on monitoring and organizing the banking sector.

3. Governance & economic development

The interest of the corporate governance concept is a development and transition economics during the last decades certainly after financial scandals of 1997, 2001, 2002 due to moral corruption besides the lack of financial and quality experience. Therefore, researchers and academicians analyzed to study the impacts of corporate governance over the economy and community in order to achieve sustainability. The importance of corporate governance becomes more with sustainability is discussed as an object in the light of transparency and accountability since corporate governance works to improve the efficiency of using the natural resources and support moral competition among international corporations in accordance with capital mobilization. Due to that, the legitimacy entities pay more attention on corporate governance to assure the rights of stakeholders since the laws and legal rules are the core stone of the relationship between external stakeholders and that affects on the international accounting standards since these laws and rules are the security lock in the light of applying corporate governance.

In the light of that, the luxury of a certain community is based on best practices of corporate governance in the public and private corporations, thus good governance practices affect positively on citizens, communities and societies since these practices grant profitability and sustainability in the long term. In another hand, that will create new job vacancies and encourage the private sector to collaborate closely with the public sector to achieve the objectives for both and for communities. In accordance with that, the board of directors issues a set of mechanisms and managerial structure assuring transparency and accountancy thus directors should consider themselves as presenters of all shareholders and from here the importance of periodical reports issue by executives and boards of directors is highlighted, these reports will be discussed publicly with all shareholders to enable them to make the final investment decision besides that the audit committee has a significant role before making the final decisions of shareholders. In the light of that, auditing committee is responsible for issuing a study case over the performance of executives and directors in order to test the quality of their performance and the quality of financial reports, in addition, transparency and disclosure of financial and nonfinancial reports are important since corporate governance reports are based on them.

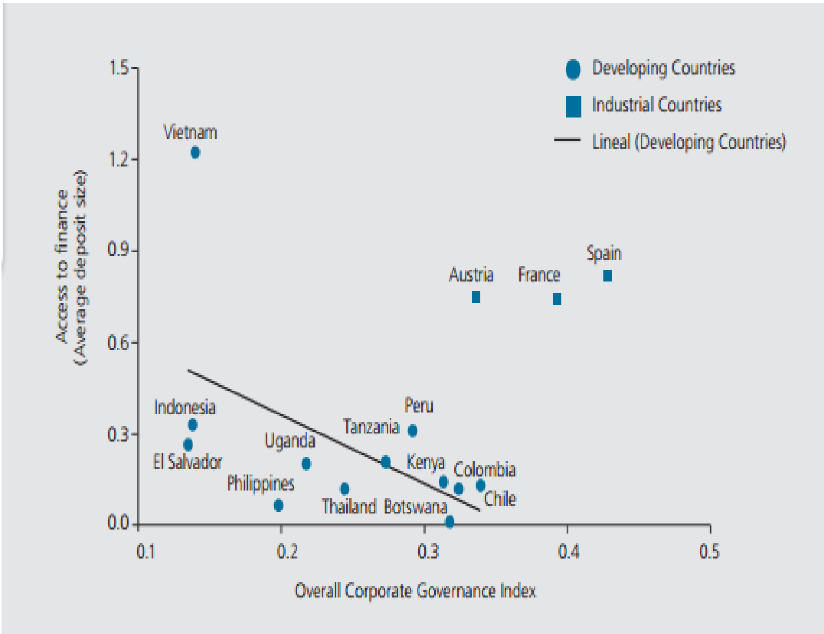
During the last two decades, the importance of a good financial system and a good practice of corporate governance beside poverty reduction are established (Levine; 1997 & World Bank 2001, 2007). The latest financial crisis has spotlighted the lack of a stable of the financial system can increase management risk and affect the global economy. Therefore, a positive impact of financial developments on the economic growth is determined in the light of best practices of corporate governance. The financial adapting is measured by a strong cross-country relationship between growth level and GDP per capita, and the relationship between industrial sector, corporations and development level of countries. The following figure illustrates this positive relationship through using data on economic growth for the last twenty years.



Relationship between Country banking system development and GDP growth

Source: Stijn Claessens and Burcin Yurtoglu 2012

In developing economic countries where property rights are better protected, companies have a greater possibilities of financial supply, thus, these companies have a better chance to grow up faster (Rajan & Zingales; 1998). The impacts of better property rights lead to a greater access to a global financing to increase the volume of business at a global level. In addition, that determines the positive relationship between corporate governance and financial supply accessibility which lead to a faster grow and develop economies at micro and macro levels. Some evidence indicates these possibilities and this positive relationship, at least in developing economic countries (World Savings Banks Institute; 2011)



Corporate governance and access to finance, measured as the average deposit size

Source: World Savings Banks Institute; 2011

Overall, the quality impacts of corporate governance practices are not limited only to access to extra financial supply, but it includes the investment capital cost and corporation valuation. In addition, these impacts affect the corporations' behavior during the financial crisis in the light of global economic influences. That means financial crises brought out a conclusion that corporate governance of financial institutions and related entities has gotten sufficient attention in development economy countries after each financial crisis in order to reduce the possibilities of another financial shock. However, poor practices of corporate governance can affect the functions of market capitals of developing economy countries and the volume of capital-cross-world financing, for instance, that can increase financial volatility since information and property rights are poorly protected due to the lack of accountability, transparency, and disclosures, and that increases the cost of investment capital and increase the debt rate and in accordance of that, the financial market enters in depression and the possibilities of financial supply is decreased maximum at the time when these possibilities are highly wanted.

Moreover, productivity is an import element in developing economy countries which is affected by the mechanisms of corporate governance that mechanisms promote economic growth. This positive relationship between economic growth and corporate governance is theoretically proved since it is difficult to issue an empirical study at the macroeconomic level since the factors can hardly be traced and determined (OECD; 2004). Legalizations that protect property rights differ clearly across developing economic countries since there are differences in legalizations and culture governance codes. The arrangements of corporate governance in emerging markets have been analyzed by Klapper and Love in 2004 and highlighted a fact that matters of corporation-level corporate governance in weak legal environments – countries, exhibit a weak shareholder protection and poor judicial access. Due to that, the matters of legal environment are less to share well-governed corporations. At the macro level, empirical studies suggest that applying corporate governance is important since it affects positively the corporation's performance. In 2000, La Porta, Lopez, Shleifer and Vishny found that strong protection of investor rights is associated with effective employing of corporate governance. Furthermore, the governance impacts on a macro level – corporations' performances, have been discussed by Denis and McConnell in 2003 in them survey about international corporate governance concluding that strong protection of investors' rights permits developments of a strong financial market to serve the economic growth.

4. Conclusion

Much concern on economic growth has wriggled the discussed since economic development has raised an enormous number of people at international level. In the industrial countries, the economic system has benefited from the wealth of rich people, but it leaves lower, middle and working citizens behind and that increases the gap among citizens in a certain community. Due to the figure below, the wealth of rich people is increased positively taking the benefits of the economic crisis at the global level and the improvement of the regional economy. The situation becomes worse when the main drivers for the wealth become poorer and here it shows the important role of corporate governance to bring the missed balance. Best practices and employing corporate governance will increase the wealth for all citizens in different percentages to support the regional economy and to expand to the global economy; in the meantime, corporate governance of banking sector supports the improvement in industrial countries and emerged economy countries through allowing different possibilities of global financial supply. That encourages the free-capital-international market to push banks to enter in a competition atmosphere which lets corporations to have access to the benefits of this competition. As a final result, corporate governance of corporations and banks supports and leads to economic growth and can be an important factor to sustain this growth besides other factors such as political issues.

Global income growth 1988-2008

Source: govpol.org

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