An Evaluation of the Impact of Central Bank of Kuwait's Corporate Governance Regulations on the Profitability of Local Banks: A Case Study of Kuwait Finance House

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Abstract

The Central Bank of Kuwait (CBK) is the main regulatory authority for Kuwaiti banks and is responsible for creating a comprehensive legislative and oversight framework and promoting strong governance standards. Since 2004, CBK has provided guidelines on prudent management and defined corporate governance as the relationship among management, the board of directors, shareholders, and other stakeholders. Following the 2008 Global Financial Crisis, the CBK strengthened its supervisory framework with new regulatory directives, and it has continued to update its guidance with significant revisions in 2012 and 2019[1].

Establishing corporate governance within banking institutions is paramount, especially given inadequate governance practices' heightened risks and consequences. Banks are integral to the economy and interact with diverse stakeholders, such as depositors, borrowers, shareholders, and employees, thereby necessitating robust governance frameworks. Effective governance structures not only play a crucial role in fostering the overall stability of the financial system but also improve the profitability and stability of individual banks.

[1] Central Bank of Kuwait. (2019). Corporate Governance Rules and Regulations in Kuwaiti Banks.

This study contends that the Central Bank of Kuwait's enforcement of corporate governance regulations has led to enhanced profitability among banks in Kuwait. The findings of the case study indicate a promising effect of these governance measures on the financial performance of Kuwait Finance House (KFH).

Keywords: Corporate governance, profitability, financial stability

Introduction

Corporate governance has emerged as a critical element of financial stability and operational efficiency in the banking sector, particularly considering global financial crises that have exposed vulnerabilities in governance frameworks. Effective governance not only fosters transparency and accountability but also aligns the interests of stakeholders, ensuring sustainable growth and profitability[1]. This research paper focuses on the role of corporate governance within Kuwait's banking sector, particularly examining the regulatory frameworks introduced by the Central Bank of Kuwait (CBK) since 2004. These regulations aim to enhance governance practices by reinforcing the responsibilities of bank boards, emphasizing risk management, and promoting transparency across financial institutions.

This research compares an Islamic bank, Kuwait Finance House (KFH), and a conventional bank, the National Bank of Kuwait (NBK), by evaluating their performance from 2010 to 2022 and linking their performance to CBK's corporate governance reforms to examine its impact on the bank's profitability. The research also aims to provide insights into

[1] Larcker, D. F., & Tayan, B. (2023). The art and practice of corporate governance (pp. 25-26). Stanford University Press. https://doi.org/10.978-1506318180.

how adherence to international governance standards can support stability and operational effectiveness within Kuwait's banking sector. Through this case study, the research will identify the positive contributions of robust governance practices to financial performance, highlighting the implications for policy and future governance enhancements in Kuwait's banking system.

Research Topic

Corporate governance has gained global importance due to financial crises that have eroded confidence in the management, financial reporting, and stock valuations of large publicly traded companies. It is not just about management metrics or oversight but serves as a comprehensive framework for the development, evaluation, and regulation of firms. Additionally, it functions within a regulatory, economic, and financial environment that seeks to preserve a careful balance between the varied array of specialized initiatives and the private sector, while simultaneously protecting the interests of the community[1].

The 2008 Global Financial Crisis underscored the importance of strong corporate governance, as inadequate practices in

[1] Al-Awadhi, B. A. (2016). Investment in governance: Legal and moral challenges. Kuwait International Law School Journal, 4(15), 9-11.

banking and other industries contributed to the crisis. Given the critical role of banks' financial products and services, robust governance is essential to ensure both individual bank integrity and the stability of the financial system, making it a key pillar of financial stability. The annual Financial Stability Report (FSR) issued by CBK is comprehensively examining significant advancements in the financial system's institutions, markets, and infrastructure, to pinpoint potential risks to financial stability[1].

In June 2012, CBK issued a set of instructions titled “Rules and Regulations of Corporate Governance in Kuwaiti Banks”[2], drawing upon lessons learned from the Global Financial Crisis and aligning with newly established international governance standards. These guidelines are covered by key documents such as the “Principles for Enhancing Corporate Governance” issued by the Basel Committee on Banking Supervision in October 2010[3], and the remuneration principles published by the Financial Stability Board (FSB) in 2009[4]. The CBK’s regulations were part of its broader framework aimed at

[1] Bank for International Settlements. (2010). Principles for enhancing corporate governance. Issued by the Basel Committee on Banking Supervision.

[2] Central Bank of Kuwait. (2012). Rules and regulations of corporate governance in Kuwaiti banks.

[3] Basel Committee on Banking Supervision. (2010). Principles for Enhancing Corporate Governance.

[4] Financial Stability Board (FSB). (2009). Remuneration Regulations.

guiding and instructing local banks in Kuwait to strengthen their governance practices. Moreover, CBK adopted the recommendations of the World Bank report issued in 2010 concerning the assessment of corporate governance principles in Kuwaiti banks in late 2010[1]. In September 2019, CBK updated governance rules for Kuwaiti banks, aligning with international standards like the Basel Committee's principles[2]. This revision emphasizes risk management, compliance, and board responsibilities, alongside Law No. 1 of 2016. The changes aim to enhance bank governance following global best practices.

The new Companies Law is aimed at providing a more practical view compared to the previous companies' law[3], with its provisions on governance, which allow the regulators to require the presence of independent directors on the boards of companies under their control, CBK updated these instructions by including some new axes in the field of governance and emphasizing the importance of other axes.

The Instructions emphasize the crucial role of corporate governance in banks, particularly the boards' responsibility for

[1] World Bank. (2010). The assessment of corporate governance principles in Kuwaiti banks.

[2] Central Bank of Kuwait. (2019). Rules and regulations of corporate governance in Kuwaiti Banks Update.

[3] State of Kuwait. (2016). Kuwait Companies Law No. 1 of 2016 and Law No. 25 of 2012.

setting goals, enhancing standards, and ensuring financial stability. Boards must protect shareholder and stakeholder interests through risk management, compliance, and audits, with a focus on independent directors safeguarding minority shareholders' rights. Initially, Kuwaiti banks faced challenges in finding qualified independent board members[1], but the Central Bank of Kuwait (CBK) gradually implemented the guidelines, approving members with relevant expertise. Directors are responsible for maintaining banking and financial knowledge, and boards must establish committees for governance, nominations, remuneration, risk, and audit oversight. This paper investigates the impact of corporate governance regulations on the financial performance of banks in Kuwait, using the Kuwait Finance House as a case study. It emphasizes the essential function of robust governance in harmonizing stakeholder interests, enhancing transparency, reducing risks, and increasing profitability.

Research Problem and Questions

This research examines the enforcement of corporate governance regulations by the Central Bank of Kuwait (CBK) and their effects on the operational performance of the Kuwait Finance House (KFH). The main research questions include:

[1] The researcher’s observation, as the Secretary General of Kuwait Banking Association 2011 - 2023.

- How have the Central Bank of Kuwait's corporate governance guidelines evolved?
- What specific changes in regulatory directives adapted by the CBK, and how do they relate to corporate governance in Kuwaiti banks?
- What role do strong governance practices play in mitigating risks associated with banking operations in Kuwait?
- What are the impacts of the CBK's governance regulations on the banking sector's profitability using Kuwait Finance House (KFH) as a case study?

Research objectives

This study aims to:

- Examine the development of the Central Bank of Kuwait's corporate governance guidelines since 2004.
- Evaluate how strong corporate governance contributes to the overall financial stability of Kuwaiti banks.
- Illustrate the positive impacts of corporate governance regulations through a case study of Kuwait Finance House.
- Provide recommendations for improving corporate governance standards in Kuwaiti banks to enhance profitability and overall financial system stability.

Research Justifications

The topic of research's importance stems from:

- The critical regulatory role of the Central Bank of Kuwait.
- The economic significance of banks in the Kuwaiti economy.
- The need for stronger governance in response to financial crises.
- The importance of stakeholder interest in governance frameworks.
- The relevance of Kuwait finance house as a case study for positive governance outcomes.

Research Methodology

The research employs a mixed-method approach:

- Literature Review: Reviewing existing literature on corporate governance, especially in Kuwait.
- Qualitative Analysis: Analysing CBK regulatory directives and key governance themes.
- Case Study: Conducting a detailed case study on Kuwait Finance House.
- Quantitative Analysis: Assessing the relationship between governance practices and financial performance indicators such as profitability and stability.

- Recommendations: offering practical solutions for improving corporate governance.

Literature Review

Numerous studies have examined the effect of corporate governance on bank performance. Researchers have focused specifically on the evidence stemming from the most recent worldwide economic downturn. In this section, the researcher will present a summary of the related literature.

Multiple papers examine the effect of insider ownership on bank performance. Griffith, Fogelberg, and Weeks (2002)[1] found a nonlinear relationship between CEO ownership and bank performance. Hughes et al. (2003)[2] indicated that higher managerial ownership can lead to entrenchment, which is often associated with mediocre performance. Barako and Tower (2007)[3] observed that both board ownership and government ownership are negatively related to bank performance. Westman (2011)[4] found that managerial ownership has a positive impact on profitability in non-traditional banks (often

[1] Griffith, J. M., Fogelberg, L., & Weeks, H. S. (2002). CEO ownership, corporate control, and bank performance. Journal of Economics and Finance, 26(2), 170-183.

[2] Hughes, J. P., Lang, W. W., Mester, L. J., Moon, C. G., & Pagano, M. S. (2003). Do bankers sacrifice value to build empires? Management incentives, industry consolidation, and financial performance. Journal of banking & Finance, 27(2), 417-447.

[3] Barako, D. G., Tower, G. (2006). Corporate governance and bank performance: Does ownership matter? Evidence from the Kenyan banking sector. Corporate Ownership & Control, 4(2), 133-144.

[4] Westman, H. (2011). The impact of management and board ownership on profitability in banks with different strategies. Journal of Banking & Finance, 35(12), 3300-3318.

referred to as fintech companies or fintech banks that offer a more flexible approach), while board ownership has a positive impact on profitability in traditional banks.

Scholars have also investigated the influence of controlling shareholders on the performance of financial institutions. Caprio, Laeven, and Levine (2007)[1] indicated that larger cash-flow rights by the controlling owner boost bank valuations. Azofra and Santamaria (2011)[2] found that whenever there is a gap between controlling shareholders' cash flow rights and control rights, the bigger the gap, the poorer the bank's performance. Elyasiani and Jia (2008)[3] declared that institutional ownership stability has a positive impact on bank performance. Haw et al. (2010)[4] revealed that banks with concentrated ownership tend to have lower performance compared to banks with more widely distributed ownership.

Several papers investigate the effect of board size and composition on bank performance, and the results are mixed. Simpson and Gleason (1999)[5] found that a bank is less likely to

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[1] Caprio, G., Laeven, L., & Levine, R. (2007). Governance and bank valuation. Journal of Financial Intermediation, 16(4), 584-617.

[2] Azofra, V., & Santamaria, M. (2011). Ownership, control, and pyramids in Spanish commercial banks. Journal of Banking & Finance, 35(6), 1464-1476.

[3] Elyasiani, E., & Jia, J. (2008). Institutional ownership stability and BHC performance. Journal of Banking & Finance, 32(9), 1767-1781.

[4] Haw, I. M., Ho, S., Hu, B., & Wu, D. (2010). Concentrated control, institutions, and banking sector: An international study. Journal of banking & Finance, 34(3), 485-497.

[5] Simpson, W. G., & Gleason, A. E. (1999). Board structure, ownership, and financial distress in banking firms. International Review of Economics and Finance, 8(3), 281-

get into financial distress when the CEO is also the chairperson of the board, while board size and independence have no impact on the probability of getting into financial distress according to Mishra and Nielsen (2000)[1]. Belkhir (2009a)[2] found a positive relationship between board size and bank performance as measured by Tobin’s Q (Tobin's Q formula is an economic ratio used to compare a company or index's market value to its book or replacement value. The formula Q = Market Value / Total Assets can measure the relative value of a company's stock or the overall market) and return on assets. Belkhir (2009b)[3] examined governance mechanisms simultaneously and found no evidence that board size or composition is related to bank performance. Adams and Mehran (2011)[4] discovered that there is a positive correlation between board size and bank performance, however, they did not find any significant relationship between board independence and performance.

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[1] Mishra, C. S., & Nielsen, J.F. (2000). Board independence and compensation policies in large bank holding companies. Financial Management, 29(3), 51-70.

[2] Belkhir, M. (2009a). Board of directors' size and performance in the banking industry. International Journal of Managerial Finance, 5(2), 201-221.

[3] Belkhir, M. (2009b). Board structure, ownership structure and firm performance: Evidence from banking. Applied Financial Economics, 19(19), 1581-1593.

[4] Adams, B. A., & Mehran, H. (2011). Bank board structure and performance: Evidence for large bank holding companies. Journal of Financial Intermediation, forthcoming.

Researchers have also reported international evidence. Kyereboah-Coleman and Biekpe (2006)[1] examined a sample of commercial banks in Ghana and found a positive relationship between board size and bank performance. They also found a positive relationship between board independence and bank performance. Staikouras, Staikouras, and Agoraki (2007)[2] examined a sample of European banks and found that board size is negatively related to bank performance, while board composition has no impact on bank performance. Kaymak and Bektas (2008)[3] used a sample of Turkish banks and found that the presence of insiders has a positive impact on bank performance, while duality and board tenure harm bank performance. Hagendorff, Collins, and Keasey (2010)[4] examined a sample of international banks and found that board independence and diversity improve bank performance, but only in countries with strict banking regulation regimes (the

[1] Kyereboah-Coleman, A., & Biekpe, N. (2006). Do boards and CEOs matter for bank performance? A comparative analysis of banks in Ghana. Corporate Ownership & Control, 4(1), 119-126.

[2] Staikouras, P. K., Staikouras, C. K., & Agoraki, M. E. K. (2007). The effect of board size and composition on European bank performance. European Journal of Law and Economics, 23(1), 1-27.

[3] Kaymak, T., & Bektas, E. (2008). East meets West: Board characteristics in an emerging market: Evidence from Turkish banks. Corporate Governance: An International Review, 16(6), 550-561.

[4] Hagendorff, J., Collins, M., & Keasey, L. (2010). Board monitoring, regulation, and performance in the banking industry: Evidence from the market for corporate control. Corporate Governance: An International Review, 18(5), 381-395.

case of Kuwait banking). Chahine and Safieddine (2011)[1] examined a sample of Lebanese banks and found that board size is positively related to bank performance. Finally, using a sample of Chinese banks, Rowe, Shi, and Wang (2011)[2] found that higher board ownership and more independence are related to better bank performance.

Several papers have examined the effect of corporate governance on bank performance during the crisis period 2007-2009, and the results are mixed. Several papers conclude that banks with better corporate governance performed better during the crisis period. Hau and Thum (2009)[3] found that the losses incurred by German banks were correlated with the financial incompetence of supervisory boards. Peni and Vahamaa (2011)[4] found that banks with better corporate governance had higher profitability. According to the study conducted by Yeh, Chung, and Liu (2011)[5], there is a positive

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[1] Chahine, S., & Safieddine, A. (2011). Is corporate governance different for the Lebanese banking system? Journal of Management & Governance, 15(2), 207-226.

[2] Rowe, W., Shi, W., & Wang, C. (2011). Board governance and performance of Chinese banks. Banks and Bank Systems, 6(1), 3-10.

[3] Hau, H., & Thum, M. (2009). Subprime crisis and board (in-)competence: Private versus public banks in Germany. Economic Policy, 24(60), 701-752.

[4] Peni, E., & Vähämaa, S. (2011). Did good corporate governance improve bank performance during the financial crisis? Journal of Financial Services Research. Forthcoming.

[5] Yeh, Y., Chung, H., & Liu, C. (2011). Committee independence and financial

correlation between the presence of independent directors on auditing and risk committees and improved performance during crisis periods. Grove et al. (2011)[1] found that corporate governance better explained bank performance than loan quality. Muller-Kahle and Lewellyn (2011)[2] found that subprime lenders had busier boards, had less tenure, and were less diverse concerning gender. Other papers conclude that banks with better corporate governance did not perform better during the crisis period. Beltratti and Stulz (2011)[3] constructed a sample of large international banks and found that banks with more shareholder-friendly boards performed worse during the crisis period than other banks. Erkens, Hung, and Matos (2010)[4] found that banks with more independent boards and higher institutional ownership experienced worse stock returns during the crisis period. Aebi, Sabato, and Schmid (2011)[5]

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institution performance during the 2007-08 credit crunch: Evidence from a multi-country study. Corporate Governance: An International Review, 19(5), 437-458.

[1] Grove, H., Patelli, L., Victoravich, L., & Xu, P. (2011). Corporate governance and performance in the wake of the financial crisis: Evidence from US commercial banks. Corporate Governance: An International Review, 19(5), 418-436.

[2] Muller-Kahle, M. I., & Lewellyn, K. B. (2011). Did the board configuration matter? The case of US subprime lenders. Corporate Governance: An International Review, 19(5), 405-417.

[3] Beltratti, A., & Stulz, R. M. (2011). The credit crisis around the globe: Why did some banks perform better? Journal of Financial Economics. Forthcoming.

[4] Erkens, D., Hung, M., & Matos, P. (2010). Corporate governance in the 2007-2008 financial crisis: Evidence from financial institutions worldwide. Working Paper, University of Southern California.

[5] Aebi, V., Sabato, G., & Schmid, M. (2011). Risk management, corporate governance,

found that standard corporate governance variables were not related to bank performance during the crisis period. However, banks where the chief risk officer reported directly to the board of directors exhibited superior performance.

In conclusion, the literature on corporate governance and bank performance reveals a complex and multifaceted relationship. Research findings vary depending on the governance mechanisms, ownership structures, and economic context. Insider ownership, board size and composition, and the presence of controlling shareholders all demonstrate varying impacts on bank performance across different studies and regions. During the 2007-2009 Global Financial Crisis, the role of corporate governance became especially pronounced, with studies indicating that stronger governance improved performance, while others reported the opposite. This divergence underscores that evaluating the role of corporate governance in banking performance requires considering a wide range of factors, suggesting that contextual variables such as market conditions, regulatory environments, and ownership structures influence the relationship[1]. Therefore, institutions

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and bank performance in the financial crisis. Journal of Banking & Finance. Forthcoming.

[1] Ajogwu, F., & King, M. (2020). Outcomes-based governance: A modern approach to corporate governance. Lagos Business School Publishing. ISBN: 978-9785205361.

should carefully tailor corporate governance mechanisms to their unique characteristics and the broader economic climate.

Consequently, this research is divided as follows:

- **I. Corporate Governance Framework in Kuwaiti Banks**
  - A. Case Study – KFH Corporate Governance Rules and Regulations
- **II. Financial Stability and Banking Indicators Development in Kuwaiti Banks**
  - A. The Relationship Between Corporate Governance and Profitability
  - B. The Impact of Effective Corporate Governance on Key Indicators of Banks' Profitability in Kuwait

I. Corporate Governance Framework in Kuwaiti Banks

Corporate governance encompasses the framework of rules, practices, and processes that guide the direction and control of a financial institution. It pertains to the governance of banks and the objectives they aim to achieve. This framework delineates the individuals who hold authority and accountability, along with those tasked with making decisions. While formulating and executing the governance strategy, banks adhered to the fundamental principles of the governance framework as outlined by the Central Bank of Kuwait[1]. The following is a highlight of the basic pillars of the corporate governance framework:

- Board oversight.
- Risk Governance & Internal Controls
- Stakeholder Protection
- Disclosure & Transparency
- Remuneration & Performance Management.
- Sustainability & Corporate Social Responsibility (CSR)

Kuwaiti banks lead in transparency, with robust monitoring systems enhancing trust and integration within banking operations. Comprehensive practices cover internal control, risk management, and compliance, as well as supporting regulatory changes and customer needs[2]. The framework defines roles for boards, Sharia supervisory functions, and executive management in Sharia-compliant banks, which are aligned with regulations and international standards. Kuwaiti banks prioritize transparency and accountability, detailing board of directors' composition, committee roles, and executive management functions. Policies manage related parties' transactions and conflicts of interest, ensuring integrity and

[1] Central Bank of Kuwait. (2019). Rules and regulations of corporate governance in Kuwaiti Banks Update.
[2] Kuwait Banking Association. (2020). Internal Follow-up Dept., Report.

compliance. The Board fosters organizational culture, supervising management, and strategic direction for long-term value creation. Various committees oversee risk management, compliance, governance, and audit functions. The banks regularly review and update key performance indicators KPIs for governance aligned with strategic objectives in Corporate Governance Manuals. Kuwaiti banks actively adopt global best practices and regulations to enhance governance[1].

Regulators mandate Kuwaiti banks to provide accurate and timely information to both shareholders and regulators, ensuring transparency. The board of directors is responsible for overseeing operations and safeguarding stakeholders' interests, with a strong emphasis on diversity and independence. Key shareholder rights, including voting rights and equitable treatment, are fundamental. Effective risk management, encompassing comprehensive risk assessments and internal controls, is critical for maintaining financial stability. Ethical standards, such as preventing money laundering and fraud, are essential to uphold integrity. A robust corporate governance framework enhances transparency, protects stakeholders, and sustains public trust[2].

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[1] Ibid

[2] Tricker, R. I. (2019). Corporate governance: Principles, policies, and practices (4th ed.) (pp. 84-99). Oxford University Press. ISBN: 978-0198809866.

Adherence to regulations helps banks avoid penalties and legal conflicts, fostering positive relations with regulatory authorities. Ethical practices and transparency also strengthen a bank's reputation and brand, attracting customers and providing a competitive advantage. The board of directors in a Kuwaiti bank consists of eleven members, including four independent directors and 1 executive director, meeting Central Bank requirements. The Chairperson fosters collaboration among board members for strategic discussions, while independent directors offer valuable perspectives that support the bank's objectives. The board prioritizes independence to ensure diverse perspectives, new skills, objective decision-making, and the protection of shareholder interests.

EY. (2012), highlighted that the presence of an independent director on a corporate board makes a significant difference in corporate governance practices[1]. The Board of Directors has the ultimate responsibility of developing and monitoring the bank's strategy within an approved risk strategy and risk appetite. The board of directors' governance role considers the checks and balances, the delegation of authorities, and a robust internal control framework implemented by executive management.

[1] EY. (2012). Corporate Governance: Changing Regulatory Scenario and the Role of Independent Director.

Several key committees support the governance framework of Kuwaiti banks, overseeing various aspects of bank operations and ensuring compliance with both internal and external regulations. The Board Corporate Governance Committee ensures adherence to corporate governance standards, Sharia compliance, and transparency while protecting stakeholder interests. The Board Risk Committee manages banking and credit risks, reviews risk management strategies, and ensures compliance with the bank's risk appetite. The Audit and Compliance Committee supervises internal controls, audits, and financial reporting, ensuring compliance with International Financial Reporting Standards (IFRS)[1].

The Board Compensations and Nomination Committee oversees remuneration policies, ensuring alignment with Sharia principles and best practices while assessing board performance and succession planning. The Board Executive Committee oversees operational risks, financing transactions, and digital transformation strategies, collaborating with other committees to maintain effective banking operations.

Most of the members of the board of directors in Kuwaiti banks have diverse expertise in banking, finance, economics, strategic planning, and risk management. They maintain effective and

[1] Kuwait Banking Association. (2021). Researcher personal communications and key management interviews.

transparent communication to oversee executive management, align strategy, and protect shareholder interests. The banks uphold corporate governance as a core cultural value, not just a regulatory obligation. The head of research in the Kuwait Banking Association stated that local banks view governance as a cultural norm, not just compliance[1]. The Board operates within the Bank's by-laws and charter, monitoring the transformation plan, governance framework, strategy implementation, and risk appetite. Subcommittees oversee key operations to enhance the corporate governance framework in line with CBK regulations.

Kuwaiti banks prioritize transparency, ethics, and integrity, implementing codes of conduct, whistleblower protections, and conflict-of-interest policies to maintain accountability and protect stakeholders. They also focus on open communication with shareholders, investor protection, employee rights, and customer satisfaction, ensuring the banks operate in a secure, compliant, and ethical manner while aligning with Central Bank of Kuwait requirements. Management uses key performance indicators (KPIs) to guide decisions and drive improvements across all areas[2].

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[1] Ibid

[2] Boubyan Bank. (2022). Researcher personal communications and key management interviews.

Kuwaiti Islamic banks follow strict Sharia compliance under the guidance of the Sharia Supervisory Board and undergo internal and external Sharia audits. Risk management is a critical function, ensuring alignment with regulatory standards and addressing cybersecurity threats through policies and employee training. Compliance frameworks and anti-money laundering measures are robust, aligning with both domestic and international regulations[1].

The researcher believes that corporate governance mechanisms drive higher profitability. These include:

- Independent Board of Directors: A board with a considerable proportion of independent directors is more likely to prioritize shareholder interests in decision-making.
- Audit Committee: An independent audit committee enhances the accuracy of financial reporting and ensures regulatory compliance.
- Risk Management Framework: A robust risk management system enables banks to identify and mitigate risks, reducing losses and increasing profits.

[1] Kuwait Finance House. (2022). Researcher personal communications and key management interviews.

- Compensation Policies: Aligning compensation with shareholder interests incentivizes managers to make decisions that enhance profitability.

A. Case Study – KFH Corporate Governance Rules and Regulations

Corporate governance refers to the framework of regulations and practices that guide the management of a corporation, encompassing the relationships among management, board members, shareholders, and other stakeholders. This system is essential for promoting transparency and ethical conduct within the organization. Analysts assess profitability by evaluating a company's income concerning its costs and investments. This section examines the influence of robust corporate governance on financial performance, with a focus on the case study of Kuwait Finance House.

i. KFH Approach and Key Points[1]

KFH designed its governance framework to conform to international best practices while adhering to Islamic Sharia law, thereby promoting sustainability and focused growth. This framework embodies a comprehensive set of principles, regulations, and guidelines that facilitate effective global governance. The Board of Directors at KFH plays a crucial role

[1] Kuwait Finance House. (2023). Corporate Governance Status Report.

in leadership, oversight, and the application of expertise to establish professional standards and institutional values. They foster an environment of integrity and demonstrate skill, care, and diligence in their representation of KFH. The Board is responsible for guiding and supervising the Bank's operations to effectively generate value for both shareholders and stakeholders.

KFH's Board of Directors maintains a strong governance structure that is consistent with its operational practices. The organization champions justice and equality, protecting the rights of shareholders to promote societal advancement. Key priorities for KFH include transparency, disclosure, and the pursuit of new opportunities to enhance shareholder value. KFH acknowledges the importance of governance in promoting sustainability as a fundamental aspect of its corporate culture. Governance is a vital component of sustainability reporting and encompasses Environmental, Social, and Governance (ESG) considerations across various dimensions, including market, environment, workplace, and society. KFH aligns its strategic objectives with ESG principles to comply with global standards and meet national obligations related to environmental, social, and institutional governance.

KFH operates in accordance with Islamic Sharia principles in its transactions, with an independent Sharia Advisory Board supporting its governance structure, further backed by the Board of Directors. The institution employs a resolute forensic audit team composed of Sharia experts tasked with ensuring that operations align with the directives of the Sharia Advisory Board. This team is also responsible for conducting research, developing products, providing technical assistance, and offering guidance to the Executive Department. Additionally, KFH maintains an external forensic audit office to verify adherence to Islamic Sharia law. The General Assembly appoints this office independently upon the recommendation of the Governing Council, with an obligation to report annually to both the General Assembly and the appropriate governing body. The Corporate Governance Framework of KFH delineates the roles, policies, and procedures necessary for monitoring compliance, ethical standards, and risk management.

The bank expects employees to comply with its code of conduct, providing ethics training to uphold ambitious standards consistently. KFH governance aims to:

- Institutional organization.
- Enhancing transparency.

- Responsibility.
- Justice and equality.

ii. KFH Corporate Governance Key Principles – Governance at the Level of KFH Group

KFH Group adheres to a governance policy focused on transparency and credibility, conforming to international standards. The Governance and Sustainability Committee periodically assesses performance and updates policies to meet strategic objectives, enhance communication among companies, and monitor governance implementation across the Group.

iii. Disclosure and Transparency

KFH prioritizes transparency and equity by following a clear framework for disclosure to stakeholders, aligning with regulations and international standards. The Sustainability Report highlights the bank's environmental and social governance history, enabling a thorough evaluation of sustainability practices. KFH prioritizes stakeholder interests by actively involving them in the decision-making process and ensuring the implementation of their input.

iv. Professional Ethics

KFH ensures employees follow professional conduct rules annually reviewed by the Board to uphold integrity. The Sharia Advisory and Supervisory Board promotes ethical standards through training programs and publications. The Governing

Council reviews and signs compliance with policies yearly. KFH issued a Code of Professional Conduct and Work Ethics for continuous improvement. The Board of Directors defines standards to prevent misuse of internal information. Conflict of interest policies address potential conflicts with employees, executives, and board members, including disclosure procedures. Policies for board members, associated parties, and executive leadership are in place. KFH discloses transactions with relevant parties under International Accounting Standards to maintain transparency and banking secrecy.

v. KFH Governance Structure

KFH has a robust governance structure focusing on compliance with standards, Central Bank of Kuwait guidelines, alignment with Kuwaiti banking sector developments, and safeguarding stakeholders' rights. It also follows the Central Bank's directives for Islamic banks. KFH Board of Directors forms committees each session to enhance oversight. The board appoints chairpersons from among non-executive and independent members. Committees like Nominations and Remuneration, Risk, Audit, and Commitment need at least three non-executive members, with an independent chair. Each committee follows an internal charter outlining responsibilities, meeting frequency, and reporting process to the Board. The Chairperson cannot be part of certain committees.

The Council's committees consist of the following committees:

- Risk Committee.
- Audit and Commitment Committee.
- Nominations and Remuneration Committee.
- Governance and Sustainability Committee.
- Executive Committee.
- Investment Commission.

vi. KFH General Responsibilities of the Board of Directors

KFH's Board of Directors oversees strategic objectives, risk strategy, and governance, ensuring compliance with regulators. They supervise executive management, operations, finances, and stakeholder interests. The Chairperson, a non-executive board member separate from the CEO, undergoes an annual review by the Nominations and Rewards Committee. Board members must meet governance requirements, and the Central Bank of Kuwait and shareholders at the General Assembly approve them based on the one-share principle. Independent members meet qualifications to serve stakeholders and uphold KFH's strategy.

vii. Risk Management

KFH proactively manages risks to ensure long-term success, focusing on balancing risks and returns to minimize negative impacts on financial performance. The integration of a risk management culture in all processes promotes an ethical environment. Group-wide risk governance in Turkey, Bahrain, and Malaysia follows a three-line defence model, with employees being accountable for effective risk management in their roles. The bank mandates thorough credit risk assessments to protect its reputation. The Audit Committee oversees internal audit, which provides independent assurance.

II. Financial Stability and Banking Indicators Development in Kuwaiti Banks

The Kuwaiti banking sector faces challenges amid regional and global economic shifts yet remains stable with strong financial indicators. Data from the Central Bank of Kuwait 2023 financial stability report shows a capital adequacy ratio of 19.9% in December 2023. By the end of 2023, domestic banking assets are KD 110.4 billion, total loans reached KD 69.2 billion by the end of 2023, and deposits at KD 73.5 billion at the end of 2023[1]. Kuwaiti banks have a global presence, with branches in the Middle East, North Africa, Europe, the UK,

[1] Central Bank of Kuwait. (2023). Financial stability and banking indicators report (pp. 46–51). Central Bank of Kuwait.

the US, and Asia, making them prominent players in international banking.

Kuwait's banking sector is diverse, with five conventional banks known for their strong credit ratings and performance. The country also has a thriving Islamic banking sector, known as a leader in the field consisting of four banks after the merger of Kuwait Finance House and Ahli United Bank. Kuwaiti banks are embracing digital advancements to stay competitive globally, with the Central Bank of Kuwait promoting digitization through several initiatives like the "Shaping the Future" Strategy for future growth and development.

The "Shaping the Future" Strategy aims to tackle global economic challenges, evolving financial technologies, and changing customer needs. It incorporates innovative approaches to align with future trends and enhance operational efficiency. In February 2022, the Central Bank of Kuwait authorized digital banks and introduced electronic payment services and cybersecurity regulations. Regulators implemented a sandbox framework to assess innovative services and products, fostering both innovation and financial stability in Kuwait[1].

[1] Central Bank of Kuwait. (2022). Shaping the Future" Strategy for future growth and development (pp. 14).

Empirical studies have found a positive association between effective corporate governance practices and financial stability in banks. For example, a study by Alkulaib and Al-Enezi (2016)[1] on Kuwaiti banks showed that stronger corporate governance practices were associated with higher financial stability. Research suggests that effective corporate governance practices positively influence capital adequacy in banks. A study by Al-Hawari et al. (2014)[2] on Gulf Cooperation Council (GCC) banks, including Kuwaiti banks, found that stronger corporate governance practices were associated with higher capital adequacy ratios. Strong corporate governance practices enhance banks' risk management frameworks. A study by Naceur and Goaied (2005)[3] on Tunisian banks found that better corporate governance practices were associated with lower credit risk and improved risk management.

Research indicates that effective corporate governance practices contribute to better asset quality in banks. A study by

[1] Alkulaib, Y., & Al-Enezi, F. (2016). The impact of corporate governance on financial performance: Evidence from Kuwaiti banks. Corporate Ownership & Control, 13(1), 160-172.

[2] Al-Hawari, M., Ward, T., & Newby, R. (2014). Corporate governance and risk management in Gulf Cooperation Council banks. International Journal of Managerial Finance, 10(4), 494-516.

[3] Naceur, S. B., & Goaied, M. (2005). The determinants of the Tunisian banking industry profitability: Panel evidence. University of Tunis Working Paper, 4(1), 1-35.

Akbar and Rehman (2013)[1] on Pakistani banks found that stronger corporate governance practices were associated with lower levels of non-performing loans. Empirical evidence suggests that robust corporate governance practices positively impact liquidity management in banks. A study by Mollah et al. (2018)[2] on GCC banks, including Kuwaiti banks, found that better corporate governance practices were associated with improved liquidity risk management. Maintaining adequate capital levels is crucial for banks' stability and resilience. Moreover, effective corporate governance ensures appropriate capital buffers to absorb potential losses and support operations. Furthermore, governance practices influence risk management frameworks and asset quality monitoring. Strong risk management enhances the ability to identify, assess, and mitigate risks. Sound governance facilitates liquidity management, enabling banks to navigate financial stress. It also fosters a corporate culture focused on ethical conduct and long-term value creation.

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[1] Akbar, S., & Rehman, R. U. (2013). Impact of corporate governance on financial performance of banks in Pakistan. International Journal of Economics, Finance and Management, 2(3), 197-206.

[2] Mollah, S., Zaman, M. R., & Quoreshi, A. M. M. S. (2018). Corporate governance, risk-taking and bank performance in the GCC countries. Research in International Business and Finance, 45, 338-358.

A. The Relationship Between Corporate Governance and Profitability

Like many other countries, the Central Bank of Kuwait has implemented governance frameworks to protect the stability and profitability of its banks. Board composition affects profitability; diverse, skilled, and independent directors improve oversight, minimize conflicts, and enhance decision-making for increased profitability. The ownership structure of banks can influence their profitability[1]. In Kuwait, where family-owned banks are prevalent, effective corporate governance practices can mitigate the potential risks associated with concentrated ownership. Transparent ownership structures, clear rights and responsibilities of shareholders, and equitable treatment of all shareholders contribute to a stable and profitable banking environment[2].

International best practices, such as those outlined by the OECD Principles of Corporate Governance, also stress the value of a diverse board that brings varied perspectives, particularly in financial institutions[3]. Studies globally have found that independent, diverse boards help mitigate risks,

[1] Larcker, D. F., & Tayan, B. (2020). Corporate governance matters: A closer look at organizational choices and their consequences (3rd ed.) (pp. 21-23). Pearson Education. ISBN: 978-0136660026.
[2] The researcher's observations.
[3] OECD. (2021). Principles of Corporate Governance (pp. 33-36).

improve strategic decision-making, and align the board’s goals with shareholder interests, leading to better financial performance. The focus on independence aligns with practices in countries like the UK, where the UK Corporate Governance Code stresses board independence.

Globally, concentrated ownership is common in family-owned businesses, particularly in developing countries. However, international standards emphasize the protection of minority shareholder rights. The OECD and the G20 emphasize clear shareholder rights, equitable treatment, and strong disclosure practices[1]. Best practices in countries such as Germany and Japan emphasize transparency in ownership structures to avoid conflicts of interest and promote accountability.

Robust risk management and effective corporate governance, including credit risk assessment and market risk management, are crucial for profitability. Transparency and timely disclosure enhance investor confidence, attract capital, and improve risk assessment, leading to informed investment decisions and increased profitability.

Transparency is a cornerstone of good corporate governance. The OECD Guidelines and the Basel Committee on Banking Supervision emphasize disclosure and transparency to reduce

[1] G20/OECD. (2023). Principles of Corporate Governance Report (pp. 9-14).

information asymmetry between investors and management. The Kuwaiti banks' approach, as described, mirrors global best practices that promote regular, clear, and comprehensive disclosure of financial results, risks, and governance structures.

Strong risk management frameworks are essential in banking globally, especially considering the Basel III standards[1], which emphasize enhanced risk governance and capital requirements for banks. The focus on risk oversight in the Kuwaiti banking sector is consistent with international norms, as sound risk management is crucial for long-term profitability and financial stability.

Corporate governance aligns executive compensation with bank profitability. Incentive structures like performance-based bonuses motivate executives to enhance profitability by linking compensation to financial metrics[2]. Governance practices promoting cost control and efficiency, clear accountability, internal controls, and risk management in Kuwaiti banks lead to enhanced profitability.

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[1] Basel III establishes additional capital buffer requirements that financial institutions are obligated to uphold beyond the established minimum capital ratios. These buffers are intended to enable banks to accumulate capital reserves during prosperous periods, which can subsequently be utilized during times of economic and financial distress. This framework represents a globally accepted series of regulations formulated by the Basel Committee on Banking Supervision as a reaction to the financial crisis that occurred between 2007 and 2009. The primary objective of these measures is to enhance the regulation, oversight, and risk management practices within the banking sector.

[2] Solomon, J. (2020). Corporate governance and accountability (5th ed.). (pp. 73-79). Wiley. ISBN: 978-1119561200.

Aligning executive compensation with long-term performance is the best globally accepted practice. Both the OECD and the European Union stress that executive pay should represent sustainable long-term growth and profitability rather than short-term gains. Kuwaiti banks demonstrate a strong alignment of interests between executives and shareholders, a crucial factor in fostering responsible decision-making and profitability. A strong corporate culture promoting ethics and responsible banking practices boosts profitability by reducing misconduct and reputational risks. Prioritizing ethical conduct and responsible lending helps banks sustain long-term profitability. Effective corporate governance enhances Kuwaiti banks' profitability, investor confidence, and sector stability.

Ethical standards and corporate culture are integral to governance frameworks. The G20/OECD Principles and regulatory frameworks like the US Sarbanes-Oxley Act[1] emphasize the importance of ethical corporate performance in maintaining investor confidence and safeguarding long-term profitability. Encouraging responsible banking and promoting a

[1] The Sarbanes-Oxley Act, enacted by the U.S. Congress on July 30, 2002, was designed to safeguard investors against deceptive financial reporting practices by corporations. This legislation, commonly referred to as the SOX Act, introduced rigorous reforms to the prevailing securities regulations and established severe penalties for those who violate these laws.

strong corporate culture is key for mitigating risks, especially in the financial sector.

Corporate governance is crucial in banking for transparency and accountability. It impacts Kuwaiti banks' profitability, with studies showing a varied connection - some finding higher profits with good practices, while others find no clear link.

One of the most comprehensive studies on this topic is by Basuony, Mohamed, and Al-Baidhani (2014)[1]. They examined the impact of corporate governance on bank financial performance in the Arabian Peninsula, including Kuwait. Their findings suggest that there is a positive relationship between corporate governance and bank profitability. Specifically, they found that board size, board activism, number of outside directors, and bank age significantly affect banks' profitability. Ownership concentration, audit committee effectiveness, frequency of audit committee meetings, along the age and size of the bank, influence ROA and PM. Another study, by Issa et al. (2021)[2], found that board diversity by nationality significantly increased bank returns on assets and equity. This suggests that having a board with a diverse range of

[1] Basuony, M., & Al-Baidhani, A. (2014). The effect of corporate governance on bank financial performance: Evidence from the Arabian Peninsula. Corporate Ownership & Control / Volume 11, Issue 2, 2014 (pp. 180-181).

[2] Issa et al. (2021) Does board diversity impact bank performance in the MENA countries? A multilevel study.

perspectives can help banks make better decisions and improve their profitability.

Effective corporate governance fosters a shareholder-oriented approach, emphasizing maximizing shareholder value. Board members and executives who align with and act in the best interests of shareholders are more likely to make decisions that contribute to profitability. Empirical studies, such as those conducted by Khan and Vieito (2013)[1], found a positive relationship between shareholder orientation and firm profitability. Protecting shareholders' rights is a fundamental aspect of corporate governance. Strong shareholder rights foster a sense of trust and confidence, encouraging long-term investor commitment. Research by Claessens, Djankov, and Lang (2000)[2] found a positive association between shareholder rights and profitability in many countries, emphasizing the importance of shareholder protection for sustainable profitability.

Having independent directors on a company's board is an essential aspect of corporate governance. Independent directors are not associated with the company's management, promoting unbiased decision-making and oversight. Research by Klapper

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[1] Khan, W. A., & Vieito, J. P. (2013). CEO gender and firm performance. Journal of Economics and Business, 67, 55-66.

[2] Claessens, S., Djankov, S., & Lang, L. H. P. (2000). The separation of ownership and control in East Asian corporations. Journal of Financial Economics, 58(1-2), 81-112.

and Love (2001)[1] noted a positive correlation between board independence and firm profitability, indicating that more independent boards tend to make better strategic choices. Moreover, they found that better corporate governance is highly correlated with better operating performance and market valuation. Studies have shown that a diverse and independent board of directors can significantly influence a company's profitability. An independent board reduces the risk of conflicts of interest, enhances decision-making processes, and brings diverse perspectives to strategic planning. Research by Demsetz and Lehn (1985)[2] and Fama and Jensen (1983)[3] found a positive correlation between board independence and profitability.

Transparency and disclosure are crucial elements of corporate governance. Companies that actively disclose information about their operations, financial performance, risks, and governance practices contribute to investor confidence. Greater transparency helps investors make well-informed decisions and

[1] Klapper, L., & Love, I. (2001). Corporate governance, investor protection, and performance in emerging markets. Working Paper (pp. 24-26), World Bank.

[2] Demsetz, H., & Lehn, K. (1985). The structure of corporate ownership: Causes and consequences. Journal of Political Economy, 93(6), 1155-1177.

[3] Fama, E. F., & Jensen, M. C. (1983). Separation of ownership and control. Journal of Law and Economics, 26(2), 301-325.

reduces information asymmetry. Studies conducted by Benjamin and Fung (2014)[1] found a positive link between corporate governance, disclosure, transparency, attraction of investment capital, and firm profitability. Transparency and accountability are crucial components of good corporate governance. Companies that consistently provide accurate and timely financial information to stakeholders are more likely to attract investor confidence. Increased transparency reduces information asymmetry, thereby enhancing the company's ability to raise capital and access credit. Studies by Larcker, Richardson, and Tuna (2007)[2] show a positive relationship between transparency and profitability. Corporate governance promotes effective risk management practices, enabling companies to identify, assess, and mitigate risks. Strong risk governance mechanisms protect a company's financial health and profitability in the face of uncertainties. Research by Macey and O'Hara (2003)[3] highlights the influence of risk management practices on firm profitability, emphasizing the importance of proper risk oversight by the board and executive management. Effective risk management practices integrated

[1] Fung, B. (2014). The demand and need for transparency and disclosure in corporate governance. Universal Journal of Management, 2(2), 72-80.

[2] Larcker, D. F., Richardson, S. A., & Tuna, I. (2007). Corporate governance, accounting outcomes, and organizational performance. The Accounting Review, 82(4), 963-1008.

[3] Macey, J. R., & O’Hara, M. (2003). The corporate governance of banks. Economic Policy Review, 9(1), 91-107.

into corporate governance frameworks help companies identify and mitigate risks, reducing the probability of unexpected financial losses. Companies with robust risk management processes tend to have more stable financial performance, leading to higher profitability. A study by Deloitte (2020)[1] highlights the correlation between comprehensive risk management practices and profitability. The alignment between executive compensation and company performance is a critical aspect of effective corporate governance. Incentive structures that reward executives based on long-term profitability rather than short-term gains can align their interests with those of shareholders. Executive compensation serves as an effective tool for creating shareholder value by enhancing firm performance. A study by Rajesh K. Aggarwal and Andrew A. Samwick (2002)[2] examines how the compensation of top management teams influences the relationship between CEO pay and firm performance. Research by Jensen and Murphy (1990)[3] demonstrates that the alignment of executive compensation with firm performance leads to improved financial outcomes.

[1] Deloitte. (2020). Global risk management survey: A moving target: Refocusing risk and resiliency amidst continued uncertainty (pp. 13) (12th ed.).
[2] Carpenter, M. A., & Sanders, W. G. (2002). Strategic management. Strategic Management Journal, 23(4), 367–375. Wiley.
[3] Jensen, M. C., & Murphy, K. J. (1990). Performance pays and top management incentives. Journal of Political Economy, 98(2), 225-264.

These findings are consistent with global empirical research showing that strong corporate governance positively correlates with financial performance. Studies from various regions, including North America, Europe, and Asia, confirm that well-governed companies tend to perform better financially, experience less volatility, and maintain stronger investor confidence. Overall, the evidence suggests that good corporate governance practices can have a positive impact on Kuwaiti banks' profitability. Further research is necessary to fully understand the dynamics of this relationship.

B. The Impact of Effective Corporate Governance on Key Indicators of Banks' Profitability in Kuwait

There is a growing body of empirical evidence that suggests that good corporate governance can have a positive impact on the financial stability and profitability of banks. For example, a study by the Bank for International Settlements (BIS) (2015)[1] found that banks with strong corporate governance frameworks are less likely to experience financial distress. There is a growing body of empirical evidence that supports the theoretical framework outlined above. For example, a study by the World Bank Group (2000)[2] found that the incentive for

[1] Bank for International Settlements. (2015). Corporate governance and bank stability (pp. 34-35).

[2] The World Bank Group. (2000). Corporate governance: A framework for implementation (Magdi R. Iskander & Nadereh Chamlou, Authors, p. 2). The World

corporations such as banks and those who own and manage them to adopt internationally accepted governance standards is that these standards will help them achieve their corporate aims and attract investment. Kuwaiti banks have a strong presence in the Middle East, but there have been concerns about their corporate governance practices. The Central Bank of Kuwait implemented new regulations in 2019 to address these issues, and there are signs of improvement. A study by the Kuwait Financial Centre shows that corporate governance practices in Kuwaiti banks have been on the rise. Corporate governance best practices enhance business performance and profitability by managing risks, developing sound tactics, and ensuring long-term sustainability. Best practices in corporate governance globally emphasize the monitoring of similar financial metrics to assess profitability and operational efficiency. Metrics such as ROA, ROE, and NIM are commonly employed in performance evaluations within the banking sector, with governance reforms linked to improved financial performance in various countries, including the United States, the United Kingdom, and the European Union. The following are the most important key indicators of banks' profitability in Kuwait:

1. **Net Profit Margin**

Bank.

Enhanced net profit margin signifies proficiency in converting sales into profit. The Central Bank of Kuwait Governor notes banks are nearing pre-pandemic profit levels, with net profits reaching KD 881.6 million in 2021. Al-Shall Weekly Report[1] indicated that the Kuwaiti banking sector achieved by the end of 2022 remarkable growth in its net profits compared to 2021, as net profits (after deducting taxes and minority rights) amounted to about 1.214 billion dinars, which is a record level, and an increase of about 332.1 million dinars, or about 37.7%.

[1] Al Shall Consulting. (2022). Weekly report.

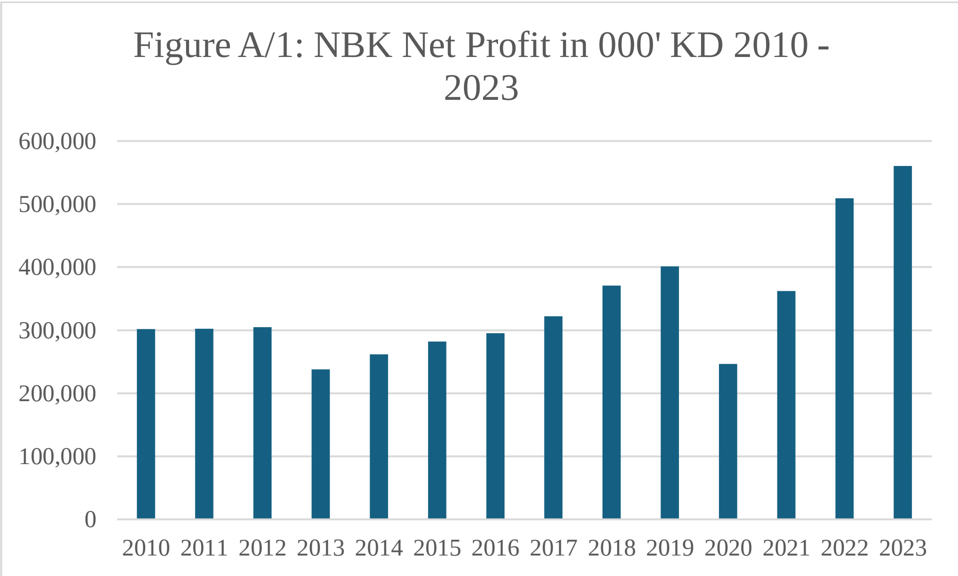
Table 1: Net Profit in (Thousands of Kuwaiti Dinars)		
Year	NBK	KFH
2010	302,000	105,983
2011	302,406	80,342
2012	305,125	87,676
2013	238,137	115,893
2014	261,810	126,476
2015	282,160	145,841
2016	295,178	165,228
2017	322,362	184,155
2018	370,709	227,411
2019	401,291	251,023
2020	246,341	148,399
2021	362,249	243,414
2022	509,085	357,716
2023	**560,600**	**584,500**

Table 1: Net Profit in 000' Kuwaiti Dinars for National Bank of Kuwait and Kuwait Finance House during 2010 – 2022.

Source: Kuwait Banking Association.

A comparative analysis of Kuwait Finance House (KFH) and the National Bank of Kuwait (NBK), one of the leading conventional banks in Kuwait and the broader MENA region, reveals a consistent growth in net profits, particularly in the period following the 2020 pandemic. This turning point coincided with the implementing of corporate governance regulations by Kuwaiti banks in alignment with the Central Bank of Kuwait's 2019 guidelines. The post-pandemic recovery highlights these governance reforms' positive impact on these institutions' financial performance. The following figures A/1 & B/1 depict the net profits of both NBK and KFH banks from 20210 to 2023.

Figure A/1: Depiction of National Bank of Kuwait net profits (2010 – 2023).



Source: The researcher's interpretation.

Figure B/1: Depiction of Kuwait Finance House net profits (2010 – 2023).

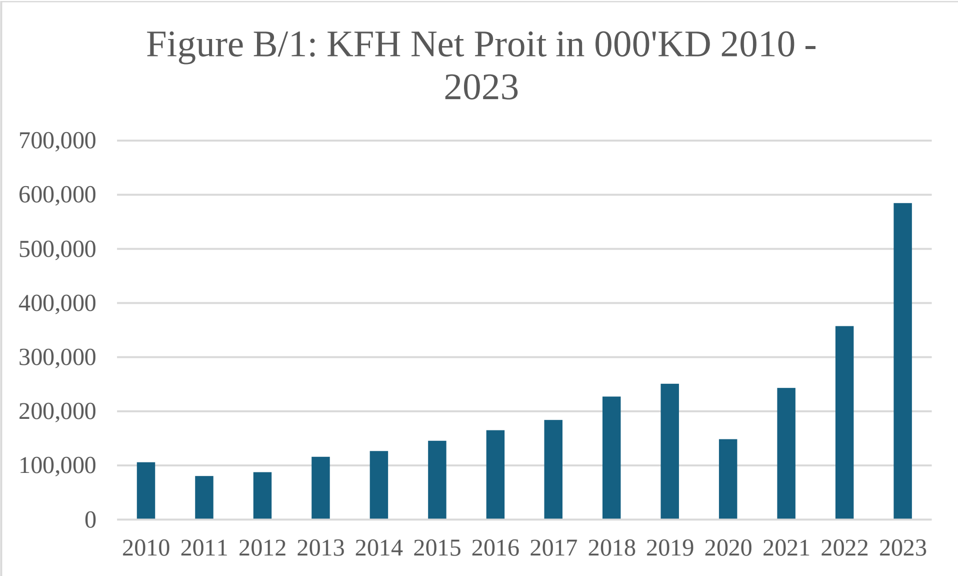


Figure B/1: KFH Net Proit in 000'KD 2010 - 2023

Source: The researcher's interpretation.

Table 2: Percentage change in net profits for National Bank of Kuwait (NBK) and Kuwait Finance House (KFH) 2010 - 2022.

NBK	Net Profit in (000's of Kuwaiti Dinars)		Percent Change	**KFH**	Net Profit in (000's of Kuwaiti Dinars)		Percent Change
2010	302,000			2010	105,983		
2019	401,291	99,291	**33%**	2019	251,023	145,040	**137%**
2022	509,085	207,085	**69%**	2022	357,716	106,693	**43%**
2023	**560,600**	51,517	**10%**	2023	**584,500**	226,784	**63%**

Source: The researcher's interpretation.

Table 2 illustrates the percentage change in net profits for both the National Bank of Kuwait (NBK) and Kuwait Finance

House (KFH) from 2010 to 2023. A consistent increase in net profits is observed for both banks, apart from the period during the COVID-19 pandemic, an expected outcome given the global crisis's widespread impact on business sectors worldwide.

Since implementing corporate governance regulations by the Central Bank of Kuwait in early 2012, both NBK and KFH have seen a doubling of their net profits. The period from 2013 to 2019 is marked by steady growth in profitability. The Central Bank of Kuwait has repeatedly emphasized the significance of its corporate governance regulations and their role in enhancing the operational efficiency of the banking sector. This impact is evident in the improved effectiveness of the boards of directors, their committees' strategies and decisions, and the overall executive management of Kuwaiti banks.

It is worth mentioning that the decline in risks in 2022 led to a decrease in the values of provisions which are mostly precautionary provisions to face the worst-case scenario. The total provisions withheld by banks in 2022 amounted to about 345.3 million dinars, compared to about 617.6 million dinars, which decreased by about 272.3 million dinars or 44.1%. The National Bank of Kuwait (NBK) achieved the highest profits among the top ten banks in 2022, reporting net earnings of 509.1 million Kuwaiti dinars, which constituted 41.9% of the total net profits and reflected a 40.5% increase from 2021. Kuwait Finance House (KFH) followed closely, with profits amounting to 357.7 million Kuwaiti dinars, representing 29.5% of the total, accompanied by a growth rate of 47%. Collectively, NBK and KFH accounted for 71.4% of the total profits generated by the top ten banks[1].

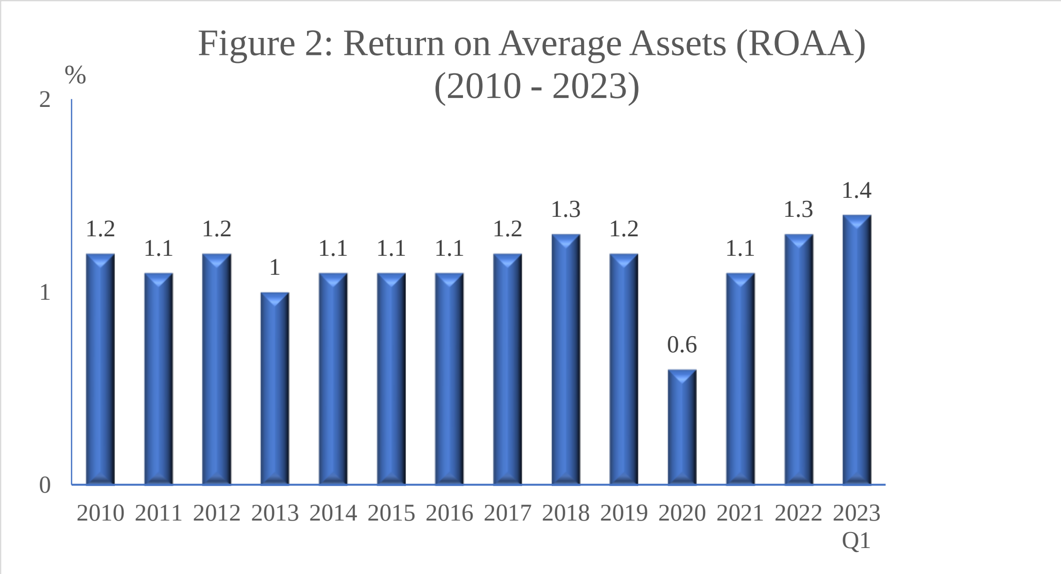
2. Return on Average Assets (ROAA)

Effective corporate governance practices contribute to effective resource allocation, risk management, and strategic decision-making, enhancing ROAA's effectiveness. Several studies have found a positive relationship between effective corporate governance practices and banks' profitability. For example, a study by Ziaee Bigdeli et al. (2016)[2] on Iranian banks found that stronger corporate governance practices were associated with higher profitability.

Figure 2: Depiction of Return on Average Assets of Kuwaiti Banks - The ratio of Net Income to Average Assets 2010 – Q1 2023.

[1] Kuwait Banking Association data base and research unit internal reports.

[2] Ziaee Bigdeli, A., Barzegar, G., & Shahrabi, A. (2016). The impact of corporate governance on bank profitability: Empirical evidence from Iran. International Journal of Management, Accounting and Economics, 3(2), 91-101.



Source: Kuwait Banking Association.

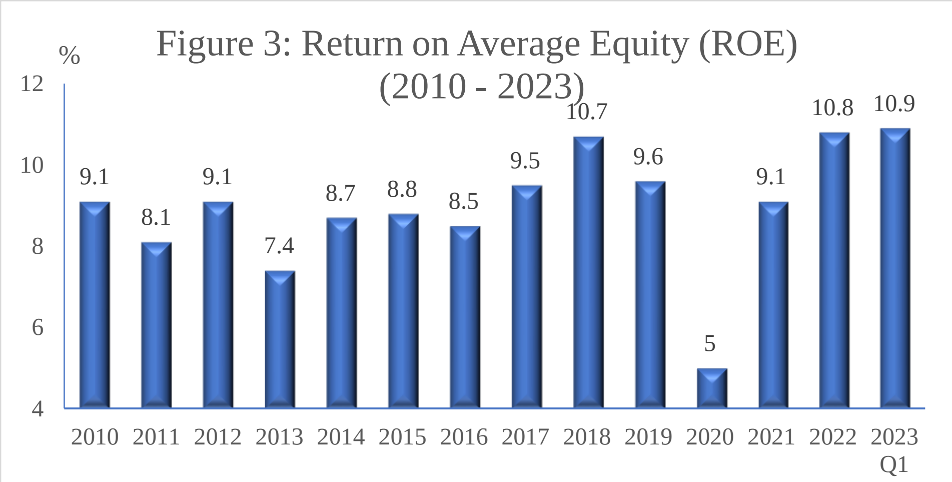
3. Return On Equity (ROE)

Robust corporate governance practices enhance banks' ability to generate sustainable returns and create value for shareholders. Research suggests that effective corporate governance practices positively influence banks' ROA and ROE. A study by Al-Tamimi and Bin-Khuzaim (2007)[1] on Saudi banks found that better corporate governance practices were associated with higher ROA and ROE. The average value of ROE for Kuwait during the period from 2000 to 2021 was 13.95 percent with a minimum of 2.18 percent in 2008 and a maximum of 27.2 percent in 2006. The latest value from 2021

[1] Al-Tamimi, H. A., & Bin-Khuzaim, K. S. (2007). Determinants of profitability of Islamic banks in the GCC region. Journal of Economic Cooperation and Development, 28(1), 83-104.

is 8.3 percent. For comparison, the world average in 2021 based on 136 countries is 13.44 percent.

Figure 3: Depiction of Return on Average Equity of Kuwaiti Banks - The Net Income to Average Shareholder Equity ratio 2010 – Q1 2023.



Source: Kuwait Banking Association.

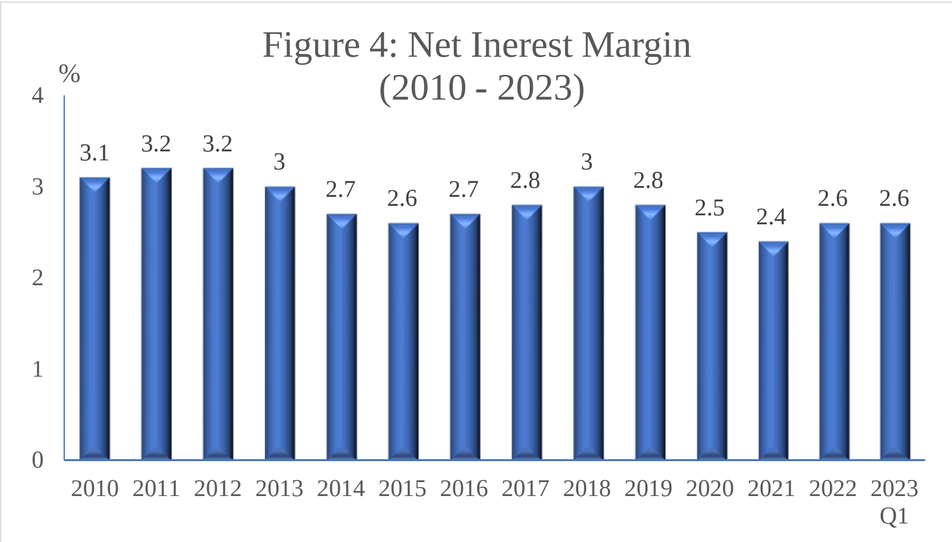
4. **Net Interest Margin (NIM)**

NIM represents the difference between a bank's interest income and interest expenses. Effective corporate governance practices enable banks to optimize their interest rate spreads, thereby positively influencing NIM. In 2021, banks in Kuwait reported a net interest margin (NIM) of 2.105%. Research shows that effective corporate governance practices positively influence banks' NIM. A study by Al-Matari et al. (2014)[1] conducted on

[1] Al-Matari, E. M., Al-Swidi, A. K., & Fadzil, F. H. (2014). The effect of corporate

Omani banks found that better corporate governance practices were associated with higher NIM. To calculate the Net Interest Margin (NIM) ratio, divide Net Interest Income by Average Interest-Earning Assets (AIEA). AIEA includes assets such as time deposits with the Central Bank of Kuwait (CBK), deposits with other banks, deposits with other financial institutions, investments in government and fixed-income securities, and net loans.

Figure 4: Depiction of Net Interest Margin in Kuwaiti Banks—The NIM ratio represents the difference between a bank's interest income and interest expenses 2010 – Q1 2023.



Source: Kuwait Banking Association.

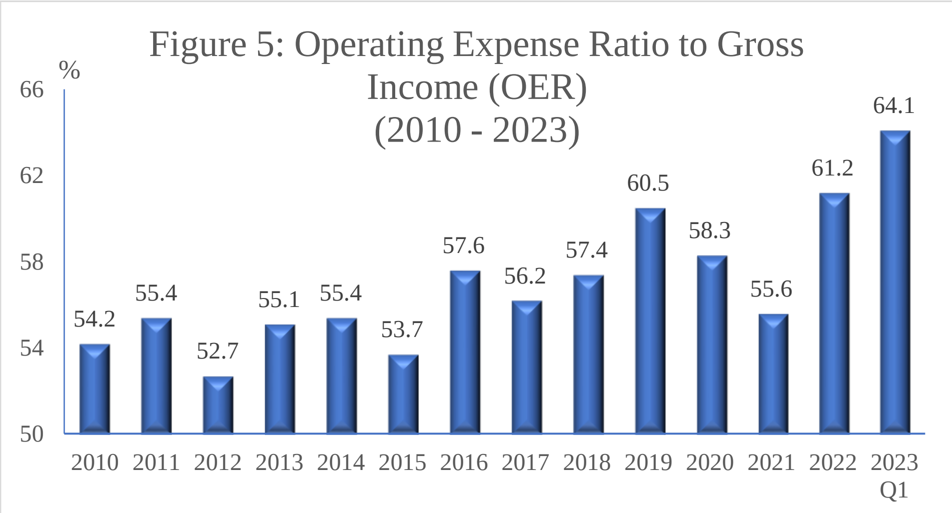
5. Cost Efficiency

governance quality on banking performance in Oman: Empirical study. International Journal of Economics and Financial Issues, 4(2), 272-281.

Corporate governance practices that promote efficiency, cost control, and effective resource allocation contribute to banks' cost efficiency. This enhances profitability by reducing operating expenses and improving productivity. Research indicates that effective corporate governance practices contribute to improved cost efficiency in banks. In a study by Al-Najjar and Abed (2011)[1] on Jordanian banks, stronger corporate governance practices were associated with higher cost efficiency.

[1] Al-Najjar, B., & Abed, S. (2011). Corporate governance and financial performance: Evidence from Jordanian banks. International Journal of Economics and Finance, 3(4), 200-213.

Figure 5: Depiction of Operating Expenses Ratio to Gross Income in Kuwaiti Banks (2010 – Q1 2023).



Source: Kuwait Banking Association.

Kuwait Finance House (KFH) KFH significantly improved its risk management practices post-implementation of the CBK's regulations. These improvements helped the bank minimize the risks associated with non-performing loans (NPLs), which led to a more stable financial performance. As a result, KFH's net profits saw a notable increase, from KD 251.0 million in 2019 to KD 357.7 million in 2022, reflecting the positive impact of better governance on profitability.

The CBK regulations mandated increased independence of bank boards, with a requirement for independent directors to take a more active role in overseeing bank operations. This improved the quality of decision-making, reduced conflicts of interest, and ensured better accountability, which in turn supported profitability.

National Bank of Kuwait (NBK) After implementing CBK’s regulations, NBK strengthened its board structure, enhancing its oversight capabilities. The bank improved the independence of its audit and risk management committees, which allowed for better supervision of financial activities. Consequently, NBK's net profits increased from KD 401.3 million in 2019 to KD 509.1 million in 2022. The bank’s more robust governance structure helped maintain profitability even during challenging economic periods.

CBK's governance reforms also focused on aligning executive compensation with long-term financial performance. By tying compensation packages, including bonuses, and key financial metrics such as return on assets (ROA) and return on equity (ROE), firms incentivized executives to prioritize sustainable profitability over short-term gains.

Kuwait Finance House (KFH) With the revised compensation structures post-2012 reforms, KFH saw a direct link between executive compensation and the bank’s financial performance. This incentivized executives to focus on long-term strategies, such as expanding Islamic banking services and improving operational efficiency, which contributed to the substantial growth in profitability mentioned above.

CBK's regulations enforced stricter disclosure and transparency requirements, ensuring that banks regularly provide detailed information on their financial performance, governance practices, and risk exposures. Increased transparency-built investor confidence attracted more capital and allowed banks to better manage financial resources.

Impact on the Banking Sector Overall, the increased transparency mandated by the CBK helped build greater investor confidence in the Kuwaiti banking system. For example, in 2022, the combined net profits of the top ten banks in Kuwait grew by 37.7%, reaching a record KD 1.214 billion. Enhanced governance led to the growth of the banks' profits due to the attraction of more capital and investment. CBK's governance framework encouraged banks to focus on cost control and operational efficiency. By reducing operating expenses and improving resource allocation, banks were able to improve their profit margins.

National Bank of Kuwait (NBK) and Kuwait Finance House (KFH) Both NBK and KFH experienced improvements in cost efficiency following the implementation of the CBK regulations. Between 2010 and 2022, the cost-to-income ratio of these banks improved as they adopted more efficient governance practices. This led to an overall increase in net profit margins, with NBK recording KD 509.1 million in net profits in 2022, up by 69% from 2019.

The implementation of CBK's corporate governance regulations significantly contributed to the profitability of Kuwaiti banks by improving risk management, enhancing board oversight, aligning executive compensation with long-term performance, increasing transparency, and promoting cost efficiency. These governance reforms not only stabilized the financial performance of banks but also positioned them for sustainable profitability growth in the long term.

Conclusion

Effective corporate governance is a cornerstone for ensuring the stability and proper functioning of the banking sector and the broader economy. Since the 2008 global financial crisis, governance frameworks have been significantly enhanced, notably through the Basel Committee’s revised Principles for Enhancing Corporate Governance in 2015 and the Central Bank of Kuwait’s (CBK) updated governance guidelines for Kuwaiti banks in 2019. These reforms have driven improvements in board oversight, risk management, and internal controls, contributing to increased financial value and profitability for Kuwaiti banks.

Strengthening governance practices included redefining the board of directors' role in overseeing risk management systems and prioritizing the expertise and commitment of board members. These measures refined risk governance, clarified responsibilities for business units and internal audit teams, and cultivated a robust organizational risk culture. Additionally, regulatory guidance ensured proper leadership selection, while revised compensation systems encouraged responsible risk-taking and reinforced a positive risk culture. Enhancements in governance elements, such as risk appetite and internal controls, have collectively bolstered the transparency, stability, and profitability of banks in Kuwait.

Kuwaiti banks have adopted diverse and independent boards of directors to strengthen risk oversight, strategic planning, and ethical standards. Independent directors bring objectivity and expertise, further reinforcing governance frameworks. Safeguarding shareholder rights—through equitable treatment, access to information, and voting rights—promotes transparency, accountability, and investor confidence. Ethical practices remain central, with banks prioritizing the prevention of money laundering, fraud, and corruption to build trust and attract customers.

The CBK has played a pivotal role in regulating corporate governance within Kuwaiti banks, issuing guidelines such as the Corporate Governance Code for Kuwaiti Listed Companies. These guidelines emphasize board composition, disclosure, and risk management. The study concludes that Kuwaiti banks’ governance practices align well with international standards, including those set by the OECD, Basel Committee, and World Bank. Positive outcomes, such as increased net profits, improved ROE, and greater cost efficiency, underscore the importance of robust governance frameworks. Nonetheless, ongoing improvements and research are essential to ensure alignment with evolving global standards.

CBK's emphasis on strong risk management frameworks has enabled Kuwaiti banks to adopt rigorous credit and market risk procedures, reducing financial risks and enhancing profitability. The research confirms that effective corporate governance is integral to the financial stability and performance of Kuwaiti banks. Through transparency, accountability, and sound decision-making, CBK’s governance rules have enhanced the sector's resilience, profitability, and credibility.

Results

The study highlights the significant impact of the Central Bank of Kuwait's (CBK) corporate governance reforms on the profitability and stability of Kuwaiti banks. Implemented in 2012 and updated in 2019, these regulations strengthened board independence, risk management, and transparency, leading to improved decision-making and accountability. Both Kuwait Finance House (KFH) and the National Bank of Kuwait (NBK) demonstrated consistent profitability growth post-regulation. KFH's profits grew from KD 251 million in 2019 to KD 584,500 million in 2023, representing a 63% increase. NBK's profits rose from KD 401.3 million in 2019 to KD 560,600 million in 2023, reflecting a 10% growth.

Key financial indicators such as Return on Average Assets (ROAA), Return on Equity (ROE), and Net Interest Margin (NIM) improved due to enhanced governance practices, including efficient resource allocation, strategic planning, and optimized interest spreads. Cost efficiency also improved, with governance reforms emphasizing operational productivity and cost control. By mandating stricter board oversight, enhanced transparency, and improved accountability, CBK's regulations boosted investor confidence, attracted capital, and strengthened financial stability across the sector. Overall, the findings underline the importance of robust governance frameworks in fostering sustainable profitability and operational efficiency within Kuwaiti banks.

Recommendations

To further enhance corporate governance in Kuwaiti banks, several key areas require attention:

1. Strengthening Risk Management Frameworks: Robust risk identification, evaluation, and mitigation strategies are essential for fostering financial stability and curbing excessive risk-taking.
2. Enhancing Stakeholder Trust: Transparent and accountable governance practices can attract more investors and customers while ensuring adherence to ethical standards.
3. Promoting Board Independence and Expertise: Independent, capable boards of directors are crucial for providing oversight, strategic direction, and ethical leadership to prevent governance failures and misconduct.
4. Prioritizing Transparency and Timely Disclosure: Regular, accurate reporting can improve market

efficiency, support informed decision-making, and enhance access to capital.

5. Focusing on Long-Term Governance Goals: A culture of responsibility and risk management encourages sustainable business practices, making banks more resilient during economic downturns.

While compliance with corporate governance regulations may involve short-term costs, long-term benefits—such as enhanced financial stability, profitability, and investor confidence—outweigh these challenges. Continued research and refinement of governance practices will ensure Kuwaiti banks remain aligned with global standards and equipped to navigate future economic and regulatory challenges.

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