

# CHALLENGES TO CORPORATE GOVERNANCE PRACTICES: CASE STUDY OF LIBYAN COMMERCIAL BANKS

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## Abstract

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The purpose of this study is to investigate corporate governance (CG) practices in Libyan Commercial Banks (LCBs) in order to find out any essential challenges that are associated with the process of adopting CG in the LCBs which became mandatory implementation in late 2010 in Libya. This study adopts a qualitative approach by conducting semi-structured interviews to collect the required data within the framework of stakeholder and new institutional theories of CG. Five LCBs are selected as units of case studies, as well as Central Bank of Libya (CBL). The results of the findings reveal that the implementation of CG code 2010 at LCBs is still in the early stages. The weakness of supervision and absence of training, as well as a lack of knowledge and political instability; are the main challenges to LCBs in complying with good CG practices and overcoming the problems of the political economics of CG. The outcome of this study will contribute to research knowledge on CG, especially in Libyan banks, by using stakeholder and new institutional theories as a theoretical framework.

**Keywords:** Corporate Governance Practices, Challenges, Libyan Banks

## 1. INTRODUCTION

The recent global financial crisis and collapse of many businesses and banks have raised a number of significant challenges. One of the major challenges that need to be effectively addressed is the impact on the effectiveness of CG policies in banks. This is an important issue, because good CG in banks is important for all stakeholders; firstly, it is important for businesses that rely on banks for financing their business at the least cost of funds. Secondly, from the regulators' perspective, good CG is important in maintaining banks stability and therefore economic growth. Banks have a key role in developed and developing countries alike, thus their stability will contribute to the economic growth by reducing the cost of resources appropriately. Therefore, CG issues are important especially in transition economies such as Libya, since Libya and many of the developing countries do not have the long-established financial organisations' infrastructure that could deal with issues that arise during the adoption of good CG practices. Several organisations have realised that the adoption of good CG practices and structure will accrue benefits such as increasing share price, protecting depositors, encouraging foreign investors and ensuring transparency and independence. The paper addresses the following

research questions within the Libyan context: What are the challenges to CG practice in the LCBs as one example of the developing countries?

Few studies have been conducted into CG practices in Libyan listed companies since CG introduced as a guideline. However, no studies in the previous literature have considered the challenges to implementing CG in the LCBs, especially after CBL decided to adopt mandatory CG principles in 2010. Therefore, this study intends to address the gap that has been found in existing research studies.

## 2. THEORETICAL FRAMEWORK

CG has been explained and analysed by using different theories such as agency theory, stakeholder theory, transaction cost theory and institutional theory. Fadun (2013) observed two traditional approaches to studying CG, which are institutional and functional. He describes the institutional approach as viewing institutions in the light of legal, regulatory and financial frameworks which reinforce the governance system, whereas the functional approach describes how different institutional frameworks work. This study will adopt both stakeholder and institutional theory to understand CG practice in a Libyan field study; these will be examined in the following section.

## 2.1. Stakeholder Theory

Stakeholder theory deals with groups such as the government, auditors, employees and others (Letza *et al.*, 2004), and extends corporate accountability to many sectors of society rather than concentrating only on shareholders (Solomon & Solomon, 2004). The Organization for Economic Co-operation and Development (OECD) Principles of Governance contend that *"The corporate governance framework should recognise the rights of stakeholders established by law or through mutual agreements and encourage active co-operation between corporations and stakeholders in creating wealth, jobs, and the sustainability of financially sound enterprises"* (OECD, 2004).

Studying corporate governance from the stakeholder theory point of view is considered as a tool to examine group relationships consisting of interactions between suppliers, employees, customers and other stakeholders. According to Gibson & O'Donovan (2007), stakeholder theory generally focuses on the interest of any group that may benefit from or be negatively impacted on by the company. Such groups include those with a non-financial interest, who have a right to be treated fairly and have access to disclosure of a wide range of information, including environmental information. In addition, Donaldson & Preston (1995), stress that the main focus of stakeholder theory is on managerial decision making, and that the interests of all stakeholders have intrinsic value, with no one set of interests dominating the others. . Moreover, Jensen (2001) argues that the successful managers are those who are considering into account the protection of all stakeholders' interests in order to create the long-term value.

In sum, stakeholder theory is useful to evaluate and analyse data regarding organisations and individuals in order to create knowledge. This theory focuses on understanding the perceptions of all or part of stakeholders who hold shares of the company. Therefore, this theory will be adopted for this study since the study focuses on perspectives of LCBs and some CBLs' managers as regulators.

## 2.2. Institutional Theory

This theory is adopted in order to answer one of the research questions: what are the factors influencing the CG practices of LCBs? Institutional theory, as defined by Huntington (1968), refers to a collection of governance structures that define the rules of relations between the political and social systems and economic development in terms of cultural elements such as values, formal and informal procedures, behaviours, norms and standards. According to Judge and Zeithaml (1992), institutional theory proposes that CG encourages organisations to identify their goals in accordance with the expectations of changes in the environment.

Institutional theory has been divided into three generations; old institutional economics theory (OIE), new institutional economics theory (NIE) and new institutional sociology theory (NIS) (Scott & Christensen, 1995). These theories are currently used in different disciplines such as accounting,

management and CG. These theories have been used in in order to understand important changes surrounding and within organisations (Covaleski and Dirsmith, 1983; Zagoub, 2011). Furthermore, in order to understand the changes faced by organisations, it is important to consider the historical context of environments to ascertain existing practices and what is happening (Perrow, 1977; North, 1990). In this context, Perrow *et al.*, (1986) state that *"For institutional analysis, the injunction is to analyse the whole organisation, to see it as a whole is to do justice to its organic character. Specific processes are, of course, analysed in detail, but it is the nesting of these processes into the whole that gives them meaning"*.

Theorists have determined three types of mechanisms that encourage institutional isomorphism change: these mechanisms are coercive, mimetic, and normative pressures (DiMaggio and Powell, 1983; Scott, 2001). Firstly, DiMaggio and Powell (1983) explain that where an institution focuses mostly on the vital resources needed in order to survive; this represents the kind of political pressure on those institutions, such as laws and regulation of the states, which may help in the emergence of coercive isomorphism. Coercive isomorphism can be described as external pressures that usually come from investors, regulators and other stakeholders to put pressure on organisations to adopt a particular system such as CG as a good practice. Secondly, in the case of mimetic isomorphism Moll *et al.*, (2006) explain that this type of isomorphism comes as a result of uncertainty, where organisations are not confident in the internal system that they have developed in their practice, and therefore these organisations adopt similar systems, practices and structures of other successful organisations, particularly those working in the same sector, in order to improve their performance and thus give them more chance of survival. Finally, there is normative isomorphism: DiMaggio and Powell (1983) argue that this mechanism arises as a result of professionalism. For example, major organisations follow other dominant professions, such as professional bodies and consultants, to build their organisational structure. Most clearly, the majority of banks are subject to some international system that is recommended by international banking organisations.

Moreover, Fogarty (1996) recommends that institutional theory is suitable for researchers who wish to find out the difference between actual practices and institutional structures in organisations. The theorists argue that several factors such as social, economic, legal and political factors have played an important role in many countries societies. These factors certainly have influences on the development of operations and thus CG practices in the country. Alam (2006) points out that the NIST can be used to understand the way in which institutions can deal with most of the external social, economic, legal and political changes that may occur, and how they can interact with the different cultures in the community. Additionally, Monks and Minow (2004) noted that the cultural factor plays an important role in the institutionalisation of CG through the power of cultural forces. Therefore, this study will also adopt institutional theory in order to achieve its objectives, since this theory focuses on economic, social,

political and cultural factors which play an important role in a country such as Libya.

### 3. LITERATURE REVIEW

#### 3.1. Concept of corporate governance

Many studies and discussions on CG in academic conferences, corporate boardrooms and policy circles around the globe have taken place in recent decades, and it is now regarded as an independent field of study (Claessens & Yurtoglu, 2013). CG has been defined from a narrow perspective as *"the ways in which suppliers of finance to corporations assure themselves of getting a return on their investment"* (Shleifer & Vishny, 1997). The OECD defines CG thus: *"Corporate governance involves a set of relationships between a company's management, its board, its shareholders and other stakeholders. Corporate governance also provides the structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performance are determined"* (OECD, 2004). In the other hand, Gourevitch & Shinn, (2005:3) defined CG from wider perspective as *"authority structure of the firm" which lies at the heart of important issues in the society"*.

CG from banking view adopted definition that provided by Basel Committee on banking supervision (2006) as *"the manner in which business and affairs of banks are governed by board of directors and senior management ...which affects how they set corporate objectives, operate the banks business on a daily basis, meet obligation of accountability to shareholders take into account the interest of other stakeholders"*. In sum up, it can be said that CG is taken to be a technique that aims to create value and transparency and satisfy stakeholders, through management systems, processes and operational practices in banking, which help empower the management of resources and assets, and promote positive relationships amongst stakeholders.

#### 3.2. Corporate Governance Mechanisms

Macey and O'Hara (2001) state that CG mechanisms for banks must cover both depositors and shareholders; thus CG mechanisms divided into internal and external mechanisms. According to Llewellyn and Sinha (2000) indicate that the internal CG mechanism should include accountability, monitoring, and control of a firm's management with regard to the use of resources and risk taking. External CG mechanisms in the banking sector include the regulator and regulation (Ciancanelli and Gonzales, 2000). The study will explain CG mechanisms and its role for enhancing a good CG practices in banks as well as to find out what the factors that may affect its implementation.

##### *Ownership Structure*

Ownership structure of any institution comprises the equity shareholders and their shareholding capability (Shleifer and Vishny, 1997). They also confirmed that the composition of the ownership can affect either positively or negatively CG practices, and thus is considered as a key to good CG system, as well as to help for decreasing the conflict between shareholders and the company's management. Therefore, the ownership structure is considered as one of the most important elements

of the company and CG effectiveness (Denis and McConnell, 2003).

##### *Board of Directors*

Board of Directors is one of the most important mechanisms for attaining best CG practices, as *"the bridge between those to whom the board is accountable and those who are accountable to the board"* (Cadbury, 2002, p. 31). Directors are working to achieve the interests of shareholders and are keen not to come into conflict with other parties (stakeholders) in the banks, because this will produce a negative result for the shareholders and the performance of the bank (Parkinson, 2002). In developing countries where external CG mechanisms are weaker, boards' ability to effectively monitor managers on behalf of shareholders is a fundamental pillar for CG. A limiting factor to this however is the concentration and family ownership (La potal *et al.*, 1999; Dallas, 2012).

##### *Audit Committee*

The Audit Committee has an important role in companies, where the Board of Directors deems it necessary to set up such a committee. Deloitte (2012) clarified that the role of audit committee as *"The audit committee is established with the aim of enhancing confidence in the integrity of an organization's processes and procedures relating to internal control and corporate reporting including financial reporting. Audit Committee provides an 'independent' reassurance to the board through its oversight and monitoring role"*. Good CG practices depend on fully implementing the principles of CG, as recommended by the Basel Committee and OECD principles. Solomon *et al.*, (2003) argue that disclosure and audit committees are important to ensure good CG practices. In addition, Ahmed & Yusuf (2005) stress that an audit committee also has an important role to play in CG principles within companies.

Several studies have been conducted on the effectiveness of CG and audit committee in different countries. For example, Jimoh and Iyoha (2012) highlighted the perspective of bank managers regarding the extent of the implementation of CG principles as well as the challenge they faced during the implementation. The results revealed that one of the main reasons for the ineffectiveness of CG in Nigerian banks is the weakness of the audit committee, where it is not doing effectively its duties in terms of appointment, fairness, and responsibility in determining the remuneration of the external auditor and non-executive director. Olayiwola (2010) states that the weakness of audit committee being in Nigerian banks considered in people who do not have enough knowledge regarding accounting and financial issues. In addition, Fanta *et al.*, (2013) found that audit committee negatively affect CG performance of banks. They explained that because the absences of members of the audit committee who have accounting and financial experts to enable them to enhance the board of directors effectively manage the banks.

### ***Disclosure and Transparency***

Disclosure and transparency are important and should be included in all models of CG (OECD, 2004). Credible disclosure and transparency is a symptom of good CG and it is pivotal for allocation of scarce resources (Healy and Papeleu, 2000 as cite by Okpara, 2011). Information disclosure can be divided into two categories: voluntary and mandatory. Voluntary disclosure involves providing financial and non-financial information via annual reports. The mandatory disclosure includes all the information that recommended by the Companies Act and Accounting Standard Boards in accordance with the rules that have been set (Desoky and Mousa, 2012).

In MENA region, there are few studies have been adopted on disclosure transparency, perhaps that because the law and regulations in these countries recommended all companies disclose their financial, non-financial and operational performance either annually or both semi-annually and annually (Sourial, 2004). IFC and Hawkamah (2008) found that the majority of banks in MENA region comply with the regulation and law regard to the disclosure. In addition, Shanikat (2011) found evidence that disclosure and transparency were observed to a large extent because IFRS and ISA have been fully adopted. In Libya, also greatest mandatory disclosure and transparency requirements are mandated by the Libyan Commercial Law (2010). But the law did not provide guidance for such disclosures or which accounting standards should be adopted to disclose these requirements.

### ***Corporate governance in emerging economies***

The general importance of CG arises from a conflict of interest between shareholders and other stakeholders, especially in banking and financial services, and that is because the public attach social value to financial services such as consumer credit and payment services (Barth *et al.*, 2012). CG in the banking industry is more important than in other industries as they play an important role in enhancing economic growth in developing countries; in addition, the banks are the main source of financing investments and capital markets (Arun & Turner, 2009). Thus, countries' economic growth and development can be impeded if the CG of their banking sector is poor or less efficient (Barth *et al.*, 2012). A bank's functions can be summarised as: facilitating the implementation of monetary policy and control and managing other companies through the provision of liquidity and providing credit (De Andres & Vallelado, 2008). Therefore, governments and regulators highly regulate the banking business, and consider it an important factor in the economic development of the country (Adhikari, 2014).

The growing body of CG literature has been widely investigated by authors with regard to comparing issues in developing countries with CG issues in developed countries. These studies differ from each other in terms of the issues and the types of organisation they focus on. Okpara (2011) suggests that more attention should be paid to these issues, particularly in developing countries, which are usually influenced by several factors such as inadequate implementation of property rights, the regulatory environment and inefficient legal and financial systems. His study, highlighting the challenges faced by companies during the implementation of CG in Nigeria found poor legal

systems and also lack of adherence to both the regulatory framework and the property rights system (Okpara, 2011). In addition, El Mehdi (2007) examined CG practices in Tunisia and discovered that there is a relationship between good CG and a company's performance; he also found that weaknesses in CG practices occur as a result of ownership concentration and the poor quality of regulation.

The existence of a corporate governance code (CGC) in a country does not necessarily mean that it is applied in practice. NIS theory indicates that it is a manipulation strategy, which means that organisations are not committed to the rules imposed as a result of external pressures. Harabi (2007) examined the state of CG in some Arab countries (Morocco, Egypt, Jordan, Lebanon and Saudi Arabia) and found that, although the majority of companies in these countries were compliant with the CG code, in practice, some companies were not. That means that effective supervision plays an important role in enhancing good CG practices. This result is in line with that of Fadun (2013), who cites evidence from the Nigerian Insurance Company that effective supervision has contributed to good corporate governance practices and thus growth. Furthermore, Barth *et al.*, (2012) stress that CG and supervisory governance and regulation should be considered as complements to each other, with the same objectives, in order to achieve prudent practices. Opara (2011) for instance examines barriers to issues and implications at a firm level of corporate governance practices in Nigeria. The study identified common barriers as the protection of minority shareholders, lack of commitment and responsibility of shareholders, regulatory framework and enforcement mechanisms concentration of ownership, transparency and disclosure.

In developing countries, some studies have been conducted on the CG phenomena in various fields, especially the banking sector. These countries include Lebanon, Jordan, Egypt, Nigeria, Bahrain and Iran. According to Otusanya (2010, cited in Adewale, 2013) the Central Bank of Nigeria's (CBN) Governor identified several factors which were considered responsible for the failure of CG in Nigerian banks; lack of investor and consumer sophistication, inadequate disclosure and transparency as to the financial position of the banks, critical gaps in the regulatory framework and regulations, uneven supervision and enforcement, in addition to unstructured governance and management processes at the CBN. Furthermore, Olayiwola, (2010) examined standards and practices of CG in Nigerian banks, using OECD criteria for assessing the level of CG implementation. He found a difference between the rules of CG and the reality of the implementation, where some of the banks do not effectively comply with these rules, and also pointed out that there must be an enforcement mechanism in place to strengthen the regulatory institutions.

In Lebanon Chahine and Safieddine (2011) observed that a positive relationship exists between the size of the boards and the banks' performance, while the board of directors' behaviour represents a fundamental problem in current CG problems. In addition, Shanikat & Abbadi (2011) investigated the reality of CG practices in Jordanian banks. They found that law and regulation contributed in identifying responsibilities that were being fulfilled and found that disclosure and transparency exist, to a large extent. However, there was no respect for the

role of stakeholders in CG, and also no equality for shareholders in practice. Furthermore, in Bahrain banks, there was evidence of positive changes in disclosure after implementing the CGC (Kukreja, 2013). Moreover, in Egyptian banks there was a positive relationship between the quality of CG and bank performance (EL Bannan and EL Bannan, 2014).

In Libya in 2005 the CBL issued guidelines on corporate governance for banks in an effort to begin the development phase of the Libyan banks, especially following the Central Bank's intention to restructure the banking system at the time. These changes included allowing the entry of foreign investors and the participation of the Libyan banks and competing with them in the market, as well as entry system privatisation. It was incumbent on the CBL to restructure the banking system in a way which would help Libyan banks in their ability to compete and to create transparency, accountability and responsibility. These guidelines were similar to the OECD 2004 principles, and the CBL decided they should be adopted to apply to the Libyan banks, through the governor's decision No. 79/2005, which asked the Libyan banks to study these rules in preparation for mandatory application in 2010. Subsequently, in 2010, the CBL issued governor's decision No. 20/2010, under which it became mandatory for the Libyan banks to implement the Libyan corporate governance code (CBL, 2010).

However, Zagoub, (2011) who conducted a study on the three banks in Libya, stresses that application of the corporate governance code was not in place when he collected the data for his study at the beginning of 2010, and also found that there was a weakness in the understanding of corporate governance, at least in those three banks. He thus recommended a future study to cover aspects that were represented as beyond the limits of his study. Therefore, the present study will cover the aspects that were not covered in the previous study, in terms of the sample size, research methods and theories.

#### 4. RESEARCH METHODS

The study is qualitative in nature, using multiple case studies to investigate CG practices in LCBs in order to obtain good quality answers to the research questions. Authors such Morse (1991, cited in Creswell (2014), argue that a qualitative approach is useful when researchers need to explore or understand a concept or phenomenon, especially when little research has been done on it. Yin (2014)

identified case study as the preferred research strategy when phenomenon and context are not readily distinguishable. Creswell (2003) suggests that multiple cases consist of a minimum of 2-4 and maximum of 12-14 cases. The choice of case study was selected as it allows the answers of the research question. Therefore, all Libyan commercial banks were targeted for investigation by the researcher. The researcher continued to collect data from bank to bank until it became clear that the outcomes were being repeated, after reaching the fourth bank. For the sake of confirming the iteration process, the researcher added another bank, which resulted in the sample comprising six banks, including the CBL.

Regarding the methods of data collection, semi-structured interviews were used to collect the required data from LCBs. A semi-structured interview is a combination of a structured and unstructured interview; the difference is only that a semi-structured interview provides an opportunity to both; the research to ask questions, and also to the interviewees to make notes during the interview about any issue the researcher might not have addressed in his/her interview questions (Wilson, 2010). The majority of interviews were done by telephone, due to the difficult situation in Libya that time, although this was expensive; however, face-to-face interviews were used with some managers from CBL when they were in the UK for training in November 2014, however, many discussion made from time to time with CBL after the interviews finished with LCBs. As the researcher is one of the CBL's employees, that made the contacts easier to find more information. Saunders *et al.*, (2012) suggest telephone interviews as a convenient mode if the cases are long distance, providing some potential advantages associated with speed, access and lower cost. 21 interviewees were selected for the in-depth investigation, from case studies of top managers in various positions, such as executive management, internal auditing and members of boards of directors of LCBs and the CBL, as shown in Table (1). In addition, telephone interviews help a researcher to conduct interviews with managers who do not have time to give face-to-face interviews, as result of the large workload on their shoulders (Fisher, 2007). Moreover, it is an especially appropriate mode when there is long distance between research sample and the researcher, and a researcher has the opportunity to hold interviews by telephone at any time agreed upon in advance that suits researcher and interviewees alike (Sekaran, 2003).

Table 1. Interviewees' sample

Research field	Coding	Number of participants	Time for each	Date
CBL	CL	3 Face-to-face	1 - 2 Hours	From time to time by phone 2014 - 2015
		2 by phone	40 min - 1 Hour	
General Manager	GM	1 Face-to-Face	40 - 1 Hour	From Jun - Oct 2014
		3 by phone		
Member of Board	MB	2 by phone		
		2 by phone		
Chairman	HC	2 by phone		
		3 by phone		
Manager of Audit Committee	MA	3 by phone		
		1 Face-to-Face		
Manager of Internal Audit	MI	1 Face-to-Face		
		4 by phone		

Regarding data analysis, Yin (2003) states that the difficulty to analysis qualitative data that there

is no clear strategies and techniques agreed. Several authors argued that there is no a standardised

approach to analysis the qualitative data (Miles and Huberman, 1994; Lincoln and Denzin, 2003; Collis & Hussey, 2003; Punch, 2005; Saunders *et al.*, 2007). However, thematic analysis is used in this study in order to explore the main themes and sub-themes that emerged through the interviews.

## 5. FINDINGS AND DISCUSSION

This paper aims to fill research gap that clearly needed investigation. However, due to the time line of the research of which this paper is a part, the researcher has reached a limited number of results at this stage of the PhD research. Therefore, these initial findings will have presented, as they are important results which have emerged from data analysis.

The interviewees were asked about existing CG practices in LCBs and whether they have implemented all the principles mentioned by CBL. These principles include size of board committees, how many committees are in place and how efficient managers and members were selected. The majority of interviewees (20 out of 21) observed that implementation has been slow as a result of both external and internal factors. The internal factors constitute committees and selection of members. External factors are the political situation of the country, banking laws and supervision. For example one of the interviewees (CL1) stated that:

*"The political situation that the country has suffered is the main challenge facing LCBs in implementing CG, which is long overdue as a result of this conflict... Thus political instability has had a significant impact on the delay in fully implementing a CG process".*

Also (CL3) support this view and said:

*"I'll be honest if I told you there is no implementation of CG in our bank. The CG system was supposed to be mandatorily implemented in late 2010, but unfortunately the events that happened in 2011 led to many problems, including lack of security, and the difficulty of implementing any regulatory action in the institutions in Libya."*

Another manager (GM3) confirmed previous observations and provided a more detailed explanation, reiterating that the process of implementation had not started in earnest:

*"It is very normal to see some banks avoiding the application of corporate governance and this is very simply that there is no awareness of its importance. The central bank produced CG guidelines in 2005, but there has not been follow-up awareness of these guidelines, nor good preparation for implementation. The absence of periodic evaluation of compliance has also contributed to the failure to apply corporate governance well, at least in our bank."*

In addition, the chairman of one of the LCBs mentioned that supervision from CBL is not efficient and thus some banks have ignored the implementation of CG. In regard to this, (HC2) said that:

*"The supervision role does not exist; we have adopted CG principles since 2010 and until now there has been no specific mechanism from CBL to follow up the process of implementation, and to the present day we have not sent any reports to CBL to illustrate the stage that LCBs have reached in CG implementation".*

This finding is in the line with those Harabi, (2007), who found that effective supervision plays an important role in enhancing good CG practices in

Arabic countries, and also those of Fadun (2013), which suggested that effective supervision contributed to good CG practices, and thus growth, in Nigerian insurance companies.

The interviewees were asked many questions in order for the researcher to obtain in depth understanding about whether LCBs had formed all the recommended committees or not. Three of the five LCB representatives responded that they do not have a risk management committee. They stated reasons for that as a lack of an efficient and specialist person to lead such a committee, as well as the instability of the country. However, two of the five LCBs had formed risk management committees in their banks. In this context, one of the interviewees (GM3) indicated that:

*"..Unfortunately. We have not formed a risk management committee because we do not have specialists or an experienced person to lead this committee. However, many problems have emerged as a result of the political situation which needs us to fix them; therefore there are priorities which must be observed from my point of view".*

Another interviewee (MA1) affirmed the above comment when he stated the following:

*"The Corporate Governance Code, as a mandatory decision, coincided with the events of the new revolution in 2011, and thus many problems occurred in the public sector, including banks, which in turn made the departments take care of the major problems rather than being concerned with the formation of the committees and their follow-up."*

One of the interviewees (MI1) said:

*"We have a risk management unit which works with the internal audit in the same department as a first step and we will separate them and then will be appointing an independent director. As I said before, the bank has a lack of qualifications and experience, especially at this time."*

However, the majority of interviewees (13 out of 21) stressed a lack of understanding about how to distinguish between the audit committee and the internal auditors' functions, and also the audit committee and risk management committee. On this point the manager of an audit committee in one of the LCBs (MA1) said that:

*"The main reason for the misunderstanding about the distinction between an audit committee and a risk management committee is lack of knowledge about these committees' tasks. In addition, there is a misunderstanding about the importance of forming these committees".*

One of interviewees (CL5) argues that:

*"I think the reason is not how to distinguish between committees. The main reason and challenges to LCBs are a lack of knowledge of CG and the absence of training. It was supposed to provide intensive training before applying mandatory CG in LCBs".*

The principles for CG in LCBs are very clear and detail all the functions of committees, but the majority (17 of 21) of interviewees believed that the mandatory implementation of CG should be included in the Libyan banking law. This finding is in the line with Okpara, (2011) who found the absence of the right system and adherence to the regulatory framework are the main challenges to implementing CG in developing countries.

Regarding the process of nomination and appointment of board members, the majority of interviewees (18 out of 21) stated that the first factor is CBL has an influence on the process of selecting members of a board, and they believe that is normally because the CBL is the authority that owned many of the LCBs. For example, one of interviewees who was working as member of a board (MB2) stated that:

*"Critically ... the selection of members of the Board of Directors and General Manager process is recommended by the Governor of the CBL and thus, there are political interventions, in what are supposed to be all the conditions of selection in accordance with the recommendations of the CG principles".*

The participants indicated significant factors that they believed to have an impact on the selection process. For example, (GM3) stated:

*"The members of the board of directors were chosen by the General Assembly through a vote, but these results will always be edited and changed, some of them at the request of the CBL."*

Another participant (GM2) supported this point of view when he said:

*"The General Assembly does its part in the selection, but there are other parties that have a strong influence in the appointment of the members that are not nominated by the shareholders. The first of them is the CBL, and now also multiple government bodies in our state."*

In addition to the two statements above, the majority of the participants agreed that CBLs had clearly defined roles in selecting the members of their board of directors and sub-committees.

The second factor that participants mentioned as important is the qualifications and experience of directors relevant to banks and financial business. In this regard, the participants were asked for their opinion on the extent to which educational qualifications and experience influence the nomination and selection of members of boards of directors and committees. Participant (CL4) observed:

*"Definitely, experience and qualifications are very important in the nomination of board members. But from my point of view and through experience, not all the qualifications are required and not all the conditions are applied, where it is supposed to be a qualification related to banking and financial specialisation, accounting or economics, and the experience must be in the same field."*

Talking about this, one interviewee (GM4) said:

*"We have on our board of directors, managers with high qualifications, but not all of them have a specialism related to banking business such as electrical or agriculture, mechanical engineering and even one language teacher. Those specialisms lack full knowledge of banks and such people on a board of directors or board committees will not contribute to the effectiveness of the board."*

Regarding formalisation of board committees in the LCBs such as an audit committee, a risk management committee, a CG committee and nomination and remuneration committees, the result showed that four of the LCBs in the sample confirmed that these committees did not exist in their banks. Two of the LCBs revealed that these committees did exist in their bank 'to some extent'. The reasons for delay to establish these committees

as explained by participants for example, one of the participants (GM2) stated:

*"The audit committee in our bank has not been formed and I think this is because there is no clear time planned for this."*

Another interviewee (GM3) supported this view and explained in more detail as follows:

*"The CG guidelines stated that it was not mandatory to establish an audit committee, and since the issuance of the mandatory application decision, all LCBs were supposed to abide by this, and to implement good Corporate Governance and follow the regulation, which is one of the fundamentals of banking law."*

One interviewee (CL1) from CBL said:

*"The absence of audit committees in the banks so far is because they are considered to be limiting the functions and duties of the Board of Directors of the bank. The decisions of the Central Bank of Libya are enforceable in accordance with the Banking Law. I believe that the Board of Directors is not aware of the benefit of the existence of this committee within the bank, as well as the management of banking supervision at the CBL being considered remiss based, in my view, on the performance of their duty for the control of these banks, and the follow-up about their level of compliance."*

In addition to all of the above, disclosure and transparency were investigated to ensure all CG principles are completely in place in LCBs. The result shows that the majority of the participants observed that the transparency and disclosure process in their banks is not efficient for several reasons including timeline of disclosure, the standard of accounting information and Banking Law. For example, the General Manager of Bank (GM2) explained:

*"In my experience, disclosure and transparency are not efficient in our bank. This is because we do not follow the regulation of LCBs provided by CBL. For example, each bank should provide the annual report on time."*

Another participant (CL4), a Chairman of banks, commented:

*"I think that disclosure is not efficient enough in LCBs in general, and in my opinion, we do not provide comprehensive disclosure to our customer and stakeholders, even though there are some fixed rules for the disclosure process, but they need to be developed and include the accounting system."*

In addition, (GM3) also explained in more detail the situation regarding disclosure and transparency in his bank, and stated:

*"In order to obtain perfect results, we need to develop not only our accounting system but also the institutional environment."*

However, at this stage of this research it can only be said that LCBs are not complying with all principles of CG which have been issued by CBL. Furthermore, interviewees from LCBs stressed the impact of legal and political pressures, social and culture pressures and lack of adequate training on CG practices. In addition, to CBL intervenes in the process of appointing directors and members of the Board of Directors. Furthermore, lack of qualified staff in term of scientific qualification and experience in the field of banks. These results support conclusion of Zagoub (2011) that LCBs are in the early stages of compliance CG, also there are many factors are affecting the process of CG implementation.



## 6. CONCLUSION

In conclusion, the paper has achieved part of the objectives of the research topic and has covered an area which has been previously ignored by researchers in Libya. The contribution of this paper is to add to new knowledge to the literature regarding existing CG practices in LCBs since 2010, when implementation became mandatory. It has also filled the research gap by using both the qualitative method and theoretical perspectives to identify the main challenges to LCBs when implementing good CG practices.

This paper is a part of PhD research study and has only answered two of the research questions. The study results showed that CG in LCBs is not effective and is still at an early stage. The results also show that the political and legal framework have an impact on CG implementation and need to be improved. In addition to that, LCBs need to provide structured staff training in order to achieve good CG practices.

Limitations of this study summarised as the number of participants was only 21, and they represented only the higher levels of the banks' managers and sub-departmental managers. In addition, the case study that was used as the strategy of this research that was limited only to LCBs, and also the sample size small. Also, the current circumstances of political instability and lack of security experienced by Libya have contributed to drawing the conclusions of this study. The final limitation was the lack of resources and previous studies on CG, not only in the banking sector, but also in all sectors in the country under study and developing countries.

Future research might focus on a comprehensive survey of all Libyan banks, comparing the level of compliance among those banks in terms of ownership and its impact on compliance, using the two methods of qualitative and quantitative data collection.

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