



Corporate Governance Impact on Insurance Firm's Performance.

The Case of Palestine

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Abstract

This study try is to examine the impact of Corporate Governance on Insurance Firm's performance in Palestine. CG was measured using board size, board meeting frequency, board committees, CEO status, and ownership structure. While return on assets (ROA) and return on equity (ROE) are used to measure the insurance sector performance. A quantitative technique, descriptive statistics, bivariate correlation were used, secondary data was obtained from the published annual reports of insurance firm's during the period 2007 - 2018. Pearson correlation and t-test are used to find whether there is a relationship between the CG variables and performance. Results indicated that board meeting frequency and CEO status have a significant impact on firm's performance, firm's that hold board meetings more frequently than others tend to achieve better performance in terms of both (ROA) and (ROE), firms in which the CEOs are also board members (CEO duality) generate higher performance than firms in which CEOs are independent from the board. Board size, board committees. Ownership structure has no significant impact on insurance firm's performance in Palestine. The researchers recommends: improving CG practices by imposing mandatory compliance with the code of CG, conducting further studies that take into consideration other sectors and variables that are not taken in this study.

Keywords

Corporate Governance, Financial Performance, Insurance Sector in Palestine

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1. Introduction

Corporate governance has recently received considerable attention from local, regional, and global companies and institutions all over the world. According to the Organization for Economic Cooperation and Development (OECD), corporate governance is defined as "the system by which business corporations are directed and controlled. The corporate governance structure specifies the distribution of rights and responsibilities among different participants in the corporation, such as, the board, managers, shareholders and other stakeholders, and spells out the rules and procedures for making decisions on corporate affairs. (Muller, 2014).By doing this, it also provides the structure through which the company's objectives are set and the means of attaining those objectives and monitoring performance" (OECD, 2004; Oman and Blum, 2005).

Therefore, good corporate governance practices are critical to the proper functioning of the economy in general and the insurance sector in particular. Specifically, good corporate governance maintains investors' confidence, lowers the cost of capital, minimizes wastages, corruption, risks and

mismanagement, enhances share price and, as a result, ensures corporate success and growth. (Sultan, 2018)

Financial performance of insurance sector which includes eight listed companies is importance to stakeholders and shareholders, since it is a main source of hedging business. Therefore, analyzing the factors that impact financial performance of insurance sector is importance. This study aims to empirically examine the impact of applying corporate governance practices on the performance of insurance sector in Palestine.

1.1. Problem statement

The impact of applying corporate governance practices on insurance companies' performance and all sectors in Palestinian reign has recently been an important topic. Thus, the main idea of this study is to examine the impact of applying corporate governance practices on the insurance firm's performance in Palestine, the study conducted to answer the following question: *Does board size, board meeting frequency, board committees, CEO status, and ownership structure affect insurance firm's performance in Palestine measured by return on assets (ROA) and return on equity (ROE)?*

1.2. Importance of Study

1. Corporate governance characteristics that might affect performance of insurance firms are of great importance to stakeholders and shareholders; the study provides evidence of whether corporate governance and insurance performance in Palestine are related.

2. Corporate financial scandals all over the world have given an increasing attention to corporate governance issues since effective corporate governance practices tend to reduce risks and financial crisis in all sectors.

1.3. Objectives of Study

Examine the impact of corporate governance practices (board size, board meeting frequency, board committees, CEO status, ownership structure) on insurance firms' performance in Palestine measured by (ROA) and (ROE).

1.4. Hypotheses of Study

1. There is a relationship between board size and insurance firms' performance measured by (ROA) and (ROE).

2. There is a relationship between board meeting frequency and insurance firms' performance measured by (ROA) and (ROE).

3. There is a relationship between board committees and insurance firms' performance measured by (ROA) and (ROE).

4. Insurance firms' performance in terms of (ROA) and (ROE) differs according to CEO status.

5. There is a relationship between ownership structure and insurance firms' performance measured by (ROA) and (ROE).

2. Literature review

The number of insurance companies licensed by the CMA reached 10 companies at the end of 2018, it operates in various types of insurance. The insurance sector in Palestine achieved growth during the year 2018 compared to its predecessor, which reached about 9.4 %.The total insurance portfolio reached \$ 279.4 million in 2018. The insurance sector is witnessing a steady development in terms of the prevalence of insurance services and products in Palestine, where the penetration rate of insurance at the end of 2018 (total insurance portfolio attributed to the gross domestic product at current prices) 1.9%, and the insurance density which indicates Per capita share of total The end of 2018 insurance portfolio is US \$ 58.5. Despite the recent insurance sector in Palestine, its performance has reached the level of the performance of the insurance sectors in the Arab countries. The average age of this sector and the legal environment is only 5.1% for Arab countries. In Palestine, this percentage is still low and does not exceed 33.0% as it was

shown that the growth rate of premiums for Palestinian insurance exceeds 14% in the average for the years 2013 and 2014 compared to 2008, while only one Arab country has reached this ratio. (PCMA, reports 2018).

2.1. Concept of Corporate Governance

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, 2015). Corporate governance refers to how organization is run, that is, how the resources of an organization are employed in pursuance of the goals of the organization (Chienjen, 2010). Corporate governance includes corporate discipline, transparency, independence, accountability, fairness, social responsibility, timely and accurate disclosure of all material matters relating to the company including the financial performance, ownership and governance arrangements (Hassan, 2010).

Good corporate governance regulates the relationship between stakeholders, their boards' members and management team. It is also defined as a "process through which shareholders induce management to act in their interests, providing a degree of investor confidence that is necessary for the capital markets to function effectively" (Guo and Kumara, 2012; Rezaee, 2009).

2.2. Palestine Code of Corporate Governance Principles

The code of corporate governance in Palestine is divided into six aspects: (1) general assembly meetings, (2) equitable shareholders rights, (3) board of directors and executive management, (4) auditing, (5) disclosure and transparency, and (6) other stakeholders. The most important principles under each of these aspects are briefly outlined below (Palestine Code of Corporate Governance Principles, 2009).

2.3. Application of Corporate Governance in Palestine

The application of corporate governance principles in Palestine is briefly discussed. This discussion depends on the Baseline Assessment of Corporate Governance in Listed Companies which was issued by the (Palestine Governance Institute in 2012): General Assembly Meetings, Board of Directors, Auditing, Disclosure and Transparency.

2.4. Corporate Governance and Corporate Performance

Najjar (2012) in his study "The Impact of Corporate Governance on the Insurance Firm's Performance in Bahrain" find that there is no statistically significant impact of corporate governance expressed by CEO status, ownership concentration, the number of employees, industry performance, and number of shares traded on firm's performance in the insurance industry expressed by the dependent variable - return on equity (ROE). On the other hand board size, firm size, number of block-holders found to have statistically significant impact on firm's performance in the insurance industry expressed by the dependent variable - return on equity (ROE). This result, confirms the importance of good governance structure on the firm and the whole economy in the long run. The researcher suggests that every insurance firm should properly define corporate governance and its mechanisms and implement them effectively in order to reach the firm's long-term goals, build stakeholders' confidence and generate positive investment flows.

Almanaseer (2013) conducted a study to assess the effect of implementing corporate governance on the performance of public shareholding service companies in Jordan. The researched utilized the survey formulate by the Jordan Securities Commission in order to measure the extent to which companies are implementing corporate governance rules. The survey contains four groups of rules. These rules are the board rules, general assembly meeting rules, shareholder equity rules, and disclosure and transparency rules.

The performance of public shareholding companies is measured using financial ratios such as (ROA), (ROE), earnings per share (EPS), market to book value (M/B) and price to earnings ratio (P/E). The study

found no statistical significant impact of implementing corporate governance rules on any of the financial ratios.

Fekadu (2015), examine the impact of corporate governance on the performance of closely regulated Ethiopian insurance Industry. The study research design with an econometric panel data of 10 Insurance companies that covers the period 2007 to 2014. Board size, board independence and board diversity have negative and insignificant effect on the performance of insurance companies while size and independence of audit committee and frequency of board meetings have positive but insignificant effect on the performance of insurance companies in Ethiopia. Thus it could be concluded that all corporate governance mechanisms have insignificant effect on the performance of insurance companies measured by return on asset.

Datta (2018) in his study "Impact of Corporate Governance on Financial Performance: A Study on DSE listed Insurance Companies in Bangladesh" find corporate governance involves promoting the compliance of law in letter & spirit and demonstrating ethical conduct. This study is conducted to examine the impact of corporate governance on the performance of insurance companies. The respective study is conducted to apprehend the relationship between corporate governance mechanisms (board size, board composition, board meetings and board audit committee) and performance of the insurance company. This study finds that the corporate governance has an impact on the performance of the insurance sector in Bangladesh. The independent variables of corporate governance (board size, board composition, board meetings and board audit committee) determine 38.20 percent of the performance (ROE) variance. Using Pearson correlation, results provide evidence of a positive relationship between board sizes and ROE as well as board meetings. Results further reveals that a negative relationship between ROE and board composition. However, the study could not provide any association between performances of the insurance (ROE) and board audit committee.

3. Methodology of research

3.1. Population and Sample

Population of the study consists all Palestinian insurance firms that are licensed by the Palestine Monetary Authority (PMA). The sample of the study consists of the nine Palestinian insurance firms that are listed and traded on the Palestine Exchange (PEX). The sample covers the period from 2007 to 2018. The firms are: Al-Masshriq Insurance Company, Palestine Insurance, Al-Wataniya Insurance, Trust. Insurance, Alahliya Insurance, Al-Takaful Islamic Insurance, Al-Alamiya Union Insurance, Tamkeen Islamic Insurance, and American life insurance.

3.2. Measurement of Variables

Performance which usually measured by return on assets (ROA) and return on equity (ROE) (Akome *et al.*, 2018).

Table 1. Dependent Variables and Their Measurement

| Variable | Measurement |
|------------------------|---------------------------------------------------|
| Return on assets (ROA) | After-tax net income \div Average total assets. |
| Return on equity (ROE) | After-tax net income \div Average total equity. |

Source: Researcher's Construction

Corporate governance application could be measured using proxies:

Board Size: is the total of board members of a company.

Board Meeting Frequency: is the total number of board meetings per year.

Board Committees: are the total number of committees in the board.

Ownership Structure: is measured by the total number of shareholders in the company.

Table 2. Independent Variables and Their Measurement

| Variable | Measurement |
|-------------------------------|---------------------------------------------------------------------------|
| Board size (BS) | The total number of members in the board. |
| Board meeting frequency (BMF) | The total number of board meetings during the year. |
| Board committees (BC) | The total number of committees in the board. |
| CEO status (CEO) | 0 if CEO is independent from the board. 1 if CEO is also board member. |
| Ownership structure (OS) | The total number of shareholders in the company. |

Source: Researcher's Construction

Statistical Tests: Two statistical tests are used in data analysis. These tests are bivariate correlation and independent samples t-test. Each of these tests is briefly discussed below.

Bivariate Correlation: Bivariate correlation is a measure of the linear association between two variables that are measured on a continuous scale. Correlation is usually measured by Pearson's Correlation Coefficient. This correlation coefficient is a number that ranges between the $H_0: \mu_1 = \mu_2$ two values of -1 and +1.

Null Hypothesis:

Alternative Hypothesis: $H_1: \mu_1 \neq \mu_2$

μ_1 stands for the mean for the first group and μ_2 stands for the mean for the second group.

3.3. Descriptive Analysis

Descriptive analysis of dependent as well as independent variables is briefly discussed as follows. Return on assets (ROA) and return on equity (ROE) are used as proxies to measure the company performance.

Table 3. Descriptive Statistics for insurance companies Performance Variables

| Variable | Minimum | Maximum | Std. Deviation | Mean |
|------------------------|---------|---------|----------------|------|
| Return on assets (ROA) | -3.26 | 2.45 | 0.97 | 0.82 |
| Return on equity (ROE) | -13.60 | 22.82 | 6.93 | 6.08 |

Source: Researcher's Computation

As indicated in Table 3, the mean value of return on assets (ROA) is 0.81% whereas the mean value of return on equity (ROE) is 6.06%. On the other hand, five variables are used as proxies to measure corporate governance. These variables are board size, board meeting frequency, board committees, CEO status, and ownership structure.

Table 4. Descriptive Statistics for Corporate Governance Variables

| Variable | Minimum | Maximum | Std. Deviation | Mean |
|-------------------------------|---------|---------|----------------|----------|
| Board size (BS) | 6 | 13 | 1.44 | 10.12 |
| Board meeting frequency (BMF) | 3 | 10 | 1.35 | 6.40 |
| Board committees (BC) | 3 | 7 | 0.98 | 4.06 |
| Ownership structure (OS) | 178 | 16,54 | 4,628.50 | 3,243.60 |

Source: Researcher's Computation

Table 4 shows that the average board size is 10 members and ranges from a minimum of 6 members to a maximum of 13 members. Moreover, the average frequency of board meetings in a year is nearly 6 times and ranges between a minimum of 3 times and a maximum of 10 times. The average number of board committees is 4 and ranges from a minimum of 3 and a maximum of 7. Finally, the average number of shareholders is 3.24 and ranges from a minimum of 178 shareholders and a maximum of 16.50 shareholders.

3.4. Testing Hypotheses

Hypothesis 1: *There is a relationship between board size and insurance companies' performance in Palestine.*

Table 5 shows that the correlation between board size and insurance companies' performance as measured by return on assets (ROA) is 0.221. This coefficient is not high or statistically significant at the 0.05 level. Thus, the hypothesis that there is a relationship between board size and performance in Palestine is rejected.

Table 5. Bivariate Correlation between Board Size and companies Performance (ROA)

| | | Performance | Board Size |
|-------------|---------------------|-------------|------------|
| Performance | Pearson Correlation | 1 | 0.221 |
| | Sig. (2-tailed) | | 0.109 |
| | N | 54 | 54 |
| Board Size | Pearson Correlation | 0.221 | 1 |
| | Sig. (2-tailed) | 0.109 | |
| | N | 54 | 54 |

Source: Researcher's Computation

Following the same procedure, Table 6 shows the results of the bivariate correlation between board size and insurance companies performance as measured by (ROE).

Table 6. Bivariate Correlation between Board Size and companies Performance (ROE)

| | | Performance | Board Size |
|-------------|---------------------|-------------|------------|
| Performance | Pearson Correlation | 1 | 0.247 |
| | Sig. (2-tailed) | | 0.071 |
| | N | 54 | 54 |
| Board Size | Pearson Correlation | 0.247 | 1 |
| | Sig. (2-tailed) | 0.071 | |
| | N | 54 | 54 |

Source: Researcher's Computation

The correlation between board size and companies performance as measured by (ROA) is 0.247. This correlation coefficient is not numerically high. In addition, the correlation coefficient is not statistically significant at the 0.05 level. Therefore, the hypothesis that there is a relationship between board size and performance in is rejected.

Hypothesis 2: *There is a relationship between board meeting frequency and insurance companies' performance in Palestine.*

Table 7 shows that the correlation coefficient between board meeting frequency and bank performance as measured by (ROA) is 0.491. This coefficient is positive and statistically significant at the 0.01 level. Thus, the hypothesis that there is a relationship between board meeting frequency and performance as measured by (ROA) is accepted.

Table 7. Bivariate Correlation between Board Meeting Frequency and insurance companies Performance (ROA)

| | | Performance | Board Meeting Frequency |
|-------------------------|---------------------|-------------|-------------------------|
| Performance | Pearson Correlation | 1 | 0.490* |
| | Sig. (2-tailed) | | 0.000 |
| | N | 54 | 54 |
| Board Meeting Frequency | Pearson Correlation | 0.490* | 1 |
| | Sig. (2-tailed) | 0.000 | |

N 54 54

Source: Researcher's Computation

*Correlation is significant at the 0.01 level (2-tailed)

Board meeting frequency is found to have a positive effect on bank performance.

Table 8 is the SPSS output of the bivariate correlation between board meeting frequency and performance as measured by return on equity (ROE).

Table 8. Bivariate Correlation between Board Meeting Frequency and insurance companies Performance (ROE)

| | | Performance | Board Meeting Frequency |
|-------------------------|---------------------|-------------|-------------------------|
| Performance | Pearson Correlation | 1 | 0.628* |
| | Sig. (2-tailed) | | 0.000 |
| | N | 54 | 54 |
| Board Meeting Frequency | Pearson Correlation | 0.628* | 1 |
| | Sig. (2-tailed) | 0.000 | |
| | N | 54 | 54 |

Source: Researcher's Computation

*Correlation is significant at the 0.01 level (2-tailed)

Table 8 shows that the correlation coefficient between board meeting frequency and performance in terms of (ROE) equals 0.627. This coefficient is statistically significant at the 0.01 level. The positive sign of the correlation coefficient indicates that board meeting frequency and performance are positively correlated. To conclude, the frequency of board meetings in the insurance companies is considered to be an important way of improving the effectiveness of the board and thus improving the performance.

Hypothesis 3: *There is a relationship between board committees and insurance companies' performance in Palestine.*

Table 9. Bivariate Correlation between Board Committees and insurance companies Performance (ROA)

| | | Performance | Board Committees |
|------------------|---------------------|-------------|------------------|
| Performance | Pearson Correlation | 1 | 0.096 |
| | Sig. (2-tailed) | | 0.480 |
| | N | 54 | 54 |
| Board Committees | Pearson Correlation | 0.096 | 1 |
| | Sig. (2-tailed) | 0.480 | |
| | N | 54 | 54 |

Source: Researcher's Computation

Table 9 shows that the correlation coefficient between board committees and performance as measured by (ROA) is less than 0.10. This coefficient is very low and not statistically significant. Thus, the hypothesis that there is a relationship between board committees and performance as measured by (ROA) is rejected. The bivariate correlation between board committees and bank performance in terms of return on equity is shown in Table 9.

Table 10. Bivariate Correlation between Board Committees and Bank Performance (ROE)

| | | Performance | Board Committees |
|------------------|---------------------|-------------|------------------|
| Performance | Pearson Correlation | 1 | 0.216 |
| | Sig. (2-tailed) | | 0.114 |
| | N | 54 | 54 |
| Board Committees | Pearson Correlation | 0.216 | 1 |
| | Sig. (2-tailed) | 0.114 | |
| | N | 54 | 54 |

Source: Researcher's Computation

Table 10 shows that the correlation coefficient between board committees and insurance companies' performance in terms of return on equity (ROE) equals 0.218. This coefficient is not statistically significant at the 0.05 level. Thus, the hypothesis that there is a relationship between board committees and performance as measured by return on equity (ROE) is rejected.

Hypothesis 4: *Companies' performance in Palestine differs according to CEO status.*

Table 11. Group Statistics for the Independent Samples T-Test (ROA)

| | CEO Status | N | Mean | Std. Deviation | Std. Error Mean |
|-----|------------------|----|--------|----------------|-----------------|
| ROA | Independent CEO | 46 | 0.6026 | 0.90174 | 0.13296 |
| | Board member CEO | 8 | 2.0125 | 0.25778 | 0.09112 |

Source: Researcher's Computation

Table 11 indicates that the mean of (ROA) have independent CEOs is approximately 0.60%. On the other hand, insurance companies in which the CEO is also a board member have a mean value of (ROA) equal to 2.01%. These figures indicate that insurance companies that have CEOs who are also board members achieve higher performance than other companies in terms of (ROA).

To test the above results formally, we look at the significance column under the t-test for equality of means in Table 11. The difference in the means of 0.60 and 2.01 for independent CEOs and board member CEOs is significant at the 0.01 level.

The hypothesis that insurance companies performance in Palestine differs according to CEO status is accepted. Specifically, banks that have independent CEOs tend to have performance worse than other insurance companies in terms of (ROA).

Table 11. Independent Samples T-Test (ROA)

| | | Levene's Test for Equality of Variances | | T-Test for Equality of Means | | |
|-----|-----------------------------|-----------------------------------------|-------|------------------------------|--------|-------|
| | | F | Sig. | t | df | Sig. |
| ROA | Equal variances assumed | 2.333 | 0.132 | -4.360 | 52 | 0.000 |
| | Equal variances not assumed | | | -8.747 | 40.185 | 0.000 |

Source: Researcher's Computation

Using (ROE), the results of the t-test are shown in Tables 12 and 13.

Table 12. Group Statistics for the Independent Samples T-Test (ROE)

| | CEO Status | N | Mean | Std. Deviation | Std. Error Mean |
|-----|------------------|----|---------|----------------|-----------------|
| ROE | Independent CEO | 46 | 3.9933 | 5.08367 | 0.74955 |
| | Board member CEO | 8 | 17.9313 | 2.46052 | 0.86992 |

Source: Researcher's Computation

As indicated in Table 12, the mean of (ROE) for insurance companies that have independent CEOs is 3.9%. On the other hand, companies in which the CEO is also a board member have a mean value of (ROE) equal to 17.9%. Obviously, the figures indicate that banks that have CEOs who are also board members achieve higher performance than other insurance companies in terms of (ROE).

Table 13. Independent Samples T-Test (ROE)

| | | Levene's Test for Equality of Variances | | T-Test for Equality of Means | | |
|-----|-----------------------------|-----------------------------------------|-------|------------------------------|--------|-------|
| | | F | Sig. | t | df | Sig. |
| ROE | Equal variances assumed | 2.205 | 0.144 | -7.557 | 52 | 0.000 |
| | Equal variances not assumed | | | -12.138 | 19.573 | 0.000 |

Source: Researcher's Computation

The t-test for equality of means in Table 13 indicates that the difference in the means of 3.9 and 17.9 is statistically significant at the 0.01 level, the hypothesis that insurance companies performance differs

according to CEO status is accepted, companies in which CEOs are also board members tend to have better performance in terms of (ROE).

Hypothesis 5: *There is a relationship between ownership structure and insurance companies' performance in Palestine.*

Table 14. Bivariate Correlation between Ownership Structure and insurance companies Performance (ROA)

| | | Performance | Ownership Structure |
|---------------------|---------------------|-------------|---------------------|
| Performance | Pearson Correlation | 1 | -0.182 |
| | Sig. (2-tailed) | | 0.187 |
| | N | 54 | 54 |
| Ownership Structure | Pearson Correlation | -0.182 | 1 |
| | Sig. (2-tailed) | 0.187 | |
| | N | 54 | 54 |

Source: Researcher's Computation

Table 15 shows the outcome of the bivariate correlation between ownership structure and bank performance in Palestine in terms of (ROE). As indicated in Table 15, the correlation coefficient between ownership structure and insurance companies' performance as measured by (ROE) is not statistically significant at the 0.05 level. Therefore, we reject the hypothesis that ownership structure and performance are related.

Table 15. Bivariate Correlation between Ownership Structure and insurance companies Performance (ROE)

| | | Performance | Ownership Structure |
|---------------------|---------------------|-------------|---------------------|
| Performance | Pearson Correlation | 1 | -0.109 |
| | Sig. (2-tailed) | | 0.430 |
| | N | 54 | 54 |
| Ownership Structure | Pearson Correlation | -0.109 | 1 |
| | Sig. (2-tailed) | 0.430 | |
| | N | 54 | 54 |

Source: Researcher's Computation

4. Conclusions

1. Board size has no significant impact on the performance of insurance companies in Palestine in terms of (ROA) and (ROE), suggest that certain board membership requirements such as a minimum number of years of experience may be more important than the board size.

2. There is a significant statistical relationship between board meeting frequency and insurance companies' performance in terms of both (ROA) and (ROE). This means that boards that meet more frequently tend to generate higher performance. This conclusion is in accordance with the fact that board meetings are considered to be the channels through which board members fulfill their monitoring role.

3. There is no significant relationship between the number of board committees and insurance companies' performance in terms of (ROA) and (ROE). This may be attributed to the committee members' lack of expertise in helping the board in the governance of the insurance companies.

4. Insurance companies' performance differs, in general, according to CEO status. The results indicate that companies that have CEOs who are also board members achieve higher performance in terms of both (ROA) and (ROE) than other companies, due to the fact that CEO duality creates more efficient communication between the board and executive management.

5. There is no significant relationship between ownership structure and insurance companies performance in terms of (ROA) and (ROE), may imply that companies management is not distinguished from ownership and this, creates the agency problem.

5. Recommendations

1. Regulators should make the code of corporate governance principles compulsory for all listed companies. In addition, continuous review of the code should be done.
2. Keeping the members of a company board to a minimum size is recommended since that minimum size enables the board to perform its supervision activities properly. Moreover, insurance companies' board must be made up of qualified professionals who are familiar with oversight function.
3. Continuous training should be given to board members and senior managers in companies to promote corporate governance practices.
4. Investors are advised to know the corporate governance characteristics of insurance sector in Palestine before investing in any of them.

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