AN INVESTIGATION INTO THE RELATIONSHIP BETWEEN CORPORATE GOVERNANCE AND FIRM PERFORMANCE IN SAUDI ARABIA AFTER THE REFORMS OF 2006

By

Abdullah Mohammed Al Mulhim

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Declaration

I Abdullah Al Mulhim hereby declare that this thesis and the work presented in it is entirely my own. Where I have consulted the work of others, this is always clearly stated.

Signed: ________________________

Date: __________________________

Dedication

This work is dedicated to my mother and father,

my wife, my lovely daughters, my brothers and my sisters.

Acknowledgment

The Prophet Mohammed (peace be upon him) says The Prophet sys: 'Whoever does not thank people (for their favour) has not thanked Allah (properly), Mighty and Glorious is He!' (Musnad Ahmad, Sunan At-Tirmidhî).

Primarily, I would like to thank Allah (God) Almighty for giving me help, guide and strength and determination to complete this thesis.

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Abstract

Corporate governance is one of the most important topics in the business world, especially in developing countries. Solid corporate governance gives investors more confidence to invest their money in the markets of developing nations. Scholars have argued that the existence of good corporate governance regulations is a fundamental factor for the protection of the capital market from financial collapse. It is also widely believed that good corporate governance achieves better firm performance.

This study aims to answer the question of whether a relationship exists between corporate governance mechanisms and the performance of non-financial firms listed on the Saudi Capital Market. As there was a major reform of corporate governance in Saudi Arabia in 2006, the study examines the period 2007–2011, to investigate the impact of the reform. Furthermore, this study seeks to explore the understanding of the concept of corporate governance in the Saudi Arabian environment among different stakeholders, and to evaluate current regulations of corporate governance.

This thesis uses two approaches to answer these research questions: quantitative methods (OLS, 2SLS, and GMM), and qualtitative methods (semi-structured interviews). The researcher employed triangulation to link and enhance the results, as well as to provide more details and explain the concept of corporate governance in Saudi Arabia, adding credibility to the findings of the quantitative results.

According to the OLS regression, the findings suggest that the corporate governance mechanisms have produced mixed results on firm performance. Most of the governance mechanisms were found to have positive relationships with performance. However, other variables such as family or individual ownership and foreign ownership have a negative effect on performance (based on Return on Assets). According to the 2SLS regression, results regarding corporate governance mechanisms were consistent with the OLS results.

To ensure confidence in these estimates, the researcher applied the dynamic GMM to address the issues of endogeniety and unobserved heterogeneity. The dynamic GMM found that some corporate governance is driven by unobserved heterogeneity and dynamic endogeniety, such as royal family board members, board sub-committees, financial firm ownership, and non-financial firm ownership.

The main findings of the semi-structured interviews supported the quantitative results with greater detail and explanations. In addition, the semi-structured interviews seek to explore the concepts, definitions, and importance of corporate governance in Saudi Arabia’s environment. Lack of awareness, cost, and time are the most frequently faced difficulties and obstacles that interfere with corporate governance in Saudi Arabia. Furthermore, the participants suggest that disclosure and transparency are needed to improve and develop in the listed companies.

Table of Contents

List of tables

List of figures

List of abbreviations

2SLS	Two Stages Least Square
BCOM	Board committees
BSIZE	Board size
CEO	Chief Executive Officer
CMA	Capital Market Authority
DW	Durbin-Watson Test
FAMOWN	Family or individual ownership
FBM	Family board members
FINOWN	Financial firms ownership
FOROWN	Foreign ownership
FSIZE	Firm size
GMM	Generalized Method of Moments
GOVOWN	Government ownership
IND	Industry dummies
IND 1	Manufacturing
IND 2	Services
IND 3	Foods
IND 4	Investment
IND 5	Trading
MANOWN	Managerial ownership
MENA	Middle East and North Africa
MOCI	The Ministry of Commerce and Industry
NEXE	Non-executive members
NFINOWN	Non-financial firms ownership
OECD	Organisation for Economic Co-Operation and Development
OLS	Ordinary Least Square
RFBM	Royal family board members
ROA	Return on Assets
ROE	Return on equity
SAA	Saudi Accounting Association
SAGIA	Saudi Arabian General Investment Authority

SAMA	Saudi Arabian Monetary Agency
TQ	Tobin's Q
VIF	Variance Inflation Factor

1 INTRODUCTION

1.1 PREAMBLE

The phrase *'corporate governance'* did not come into existence in the business environment until the 1980s (Tricker, 2012). In 1988, Cochran and Wartick published a 74-page annotated bibliography of corporate governance publications; Google now accesses over 12 million references for corporate governance (Tricker, 2012). The discussion about corporate governance has increased in recent years around the world, especially after crises and scandals such as Enron and WorldCom. After these crises, a number of countries adopted regulations to ensure good practices of corporate governance. The regulations of corporate governance are developed regularly. For example, in the United Kingdom, a new set of corporate governance guidelines was issued in September 2012. This new code deals with leadership, effectiveness, accountability, remuneration, and relations with shareholders.

A significant body of literature has discussed corporate governance in different disciplines, including management, finance, economics, law, and accounting. Durisin and Puzone (2009) described corporate governance as a multi-disciplinary subject and research topic. This may be why there is no generally accepted definition of corporate governance. Most of the definitions of corporate governance use two main approaches. These approaches almost always depend on two theories: the agency theory and the stakeholder theory. The agency theory-based approach is a simple pattern that describes corporate governance as a relationship between a company and its shareholders. The second approach, which depends on the stakeholder theory, is a more widely used pattern that describes corporate governance as a web of relationships between a company and its stakeholders, such as employees, customers, suppliers, shareholders, and managers (Solomon, 2007, p. 12). Claessen (2006) stated that corporate governance affects growth and development via several channels:

- Increased access to external financing by firms, which can lead to greater investment.
- Lower cost of capital associated with higher firm valuation, which leads to more investment, increasing growth and development.
- Better operational performance, better allocation of resources and also, better management that creates growth and development.

- The existence of good practices of corporate governance, which reduced the impact of the financial crisis.
- Better relationships with all stakeholders, that lead to improved social and labour relationships.

There are two general models of corporate governance: the Anglo-Saxon model and the European model. The model of corporate governance in Saudi Arabia is concerned with maximizing shareholders' wealth, which is influenced by the Anglo-Saxon model (Fallatah and Dickins, 2012). Therefore, the main objective of the corporate governance system in Saudi Arabia is to ensure the protection of all shareholders with stakeholder rights, such as the rights of dividends, disclosure and transparency, voting rights, and equal treatment between shareholders.

The Saudi capital market has developed in many stages from 1934 until 2003. In July 2003, the Saudi Arabian Monetary Agency (SAMA) delegated the responsibilities of the Saudi stock market operations to the Capital Market Authority (CMA), established in 2003 (Tadawul, 2012). In March 2007, the Council of Ministers agreed to establish the Saudi Stock Exchange (Tadawul) (Tadawul, 2012) as a joint stock company to look after the day-to-day transactions of the Saudi Market (Alshehri, 2012). Until 2006, there were no specific corporate governance regulations for the Saudi stock market. In February 2006, the Saudi stock market experienced a large crash that led to a loss of 25% of its value (Alshehri, 2012). After this crash, the Saudi Capital Market Authority approved the regulations of corporate governance as an important part of protecting shareholders and stakeholders.

The relationship between corporate governance and firm performance has received great attention in accounting and finance literature, especially after 1997, when the East Asian financial crisis occurred. Furthermore, the studies of the relationship between corporate governance and firm performance have also received more attention after 2001, when the scandals such as Enron and WorldCom occurred, which increased interest in studying the relationship between good corporate governance mechanisms and firm performance. The notion of the present study comes from the crash of the Saudi capital market in 2006, and also the large drop of the general index of the Saudi capital market in 2008 and suspension of trading of a number of listed companies in the Saudi capital market. These events led to the present study of the relationship between corporate governance, the new regulations in the Saudi business environment, and firm performance of the listed companies in the Saudi capital market.

The main objective of this thesis is to determine whether strong corporate governance leads to enhanced and improved firm performance or not. A number of papers have attempted to answer this question using different methods and theories. The majority of these papers addressed this question in developed countries; only a few studies examined this relationship in emerging economies. Most of the literature found a positive relationship between corporate governance mechanisms and firm performance by using different measures of firm performance and different methodologies. On the other hand, a number of studies found an insignificant relationship between performance and governance. In effect, studies on the relationship between corporate governance and firm performance have had different results from country to country. Moreover, the results of one country may differ depending on changes in the variables used in the study, whether dependent or independent variables. The techniques used to examine the relationship may change the results. For example, Beiner et al. (2004, 2006) studied the effects of board size on firm performance in Switzerland for two different periods (2001 and 2002); they found a negative effect on Tobin's Q for 2001 and a positive effect on Tobin's Q for 2002, using the same econometrics model. This indicates it may not be possible to apply the results of a study of one emerging economy, such as Malaysia or China, to Saudi Arabia, or even results from other countries in the Arabian Gulf such as Kuwait or the United Arab Emirates. Many different factors may affect the outcome, including culture, types of company structure, religion, and legal systems in a country.

1.2 RATIONALE OF THE STUDY

Before 2006, little attention was paid to corporate governance and the protection of shareholders in Saudi Arabia. Most of the shareholders were fully satisfied with the Saudi capital market because they made great profits and the share index had reached its highest point (more than 20000) before February, 2006 (Alshehri, 2012). In this situation, the shareholders were not focused on regulations to protect the investor; they had the view that the market did not need corporate governance, because investors were reaping profits. However, after the Saudi stock market crash in February 2006, also known as Black February (Falgi, 2009), investors, academics, and other stakeholders demanded that regulations be issued to protect the interests of shareholders and other stakeholders, such as banks, suppliers and employees.

The Saudi Arabian business environment is somewhat different from the governance systems in the UK and US, particularly in its ownership structure and mechanisms related to board structures. The ownership structure in Saudi Arabia often consists of large family or individual groups, foreign investors, and more active institutional government ownership, even when there are widely-dispersed shareholdings (Piesse et al., 2012). In addition, according to Piesse et al. (2012), there are some interesting differences in board structure between Saudi Arabia and the UK and US governance systems. For example, institutional investors are normally represented on the board of directors in Saudi Arabian companies only when the institution is government funded, while the presence of institutional investors in the UK and the US governance systems is more common. In addition, there is always a presence of large shareholders on the boards of Saudi companies, while they are less likely to be found on the boards of UK and US companies (Piesse et al., 2012). The method of appointment of the chairman of the board of directors is via the selection of the majority shareholders in Saudi Arabian companies; however, in UK and US companies, the chairman is selected by the board members (Piesse et al., 2012).

The Saudi capital market is one of the more active markets in developing countries (Piesse et al., 2012). Moreover, because of globalization and privatization, foreign investors have been attracted to investing in Saudi Arabia. However, the percentage of foreign investors in the listed companies in Saudi Arabia is very low. This makes the research outcome more important for foreign investors who aim to invest in the Saudi listed companies by providing them a full picture of the relationship between corporate governance mechanisms and firm performance in Saudi Arabia. An increase in the percentage of foreign investors in the Saudi capital market could lead to enhanced economic growth and benefits for the Saudi infrastructure.

This study will explore the corporate governance practices in the Saudi Arabian stock market. Saudi Arabia is one of the richest developing countries in the world (Piesse et al., 2012). Piesse et al. (2012) highlighted that Saudi Arabia has some characteristics that make it superior to other developing countries. For example, Saudi Arabia is one of the largest countries in the Middle East and North Africa (MENA), has a higher level of annual income per capita than most other

MENA countries, and has the most active stock market in the MENA region. Additionally, Saudi Arabia is a member of many of economic organisations, such as the World Trade Organization (WTO), International Monetary Fund (IMF), and World Bank and one of the largest oil producers in OPEC. These elements lend the study more importance in its analysis of how corporate governance mechanisms can affect an emerging economy with high income.

Most of the previous studies of corporate governance focused on developed countries. Most of the literature discussed the characteristics of board structures. Other studies have investigated the impact of types of external shareholders and how they affect firm performance. This study seeks to fill the gap in the literature about corporate governance in emerging economies generally, and in Saudi Arabia particularly, as one of the largest countries among developing countries, and to understand the corporate governance practices in the one of the Arabian Gulf countries and an important country in the Islamic world.

The current study will seek to examine the relationship between corporate governance and firm performance by investigating many mechanisms and practices in Saudi Arabia, with consideration of the differences in culture and the application of Shari'ya law in business transactions. To conclude, this study will seek to offer a comprehensive view of how the characteristics and practices (board of directors and ownership structure) work together to produce different effects on firm performance.

1.3 RESEARCH AIM AND OBJECTIVES

The main aim of the current study is to examine the relationship between corporate governance mechanisms and firm performance in the listed companies in the Saudi capital market. Furthermore, this study seeks to explore the understanding of the concept of corporate governance in the Saudi Arabian environment among different stakeholders, and evaluate the current regulations of corporate governance. This should provide a comprehensive study of the nature and practice of corporate governance in Saudi Arabia after the regulations were issued by the Capital Market Authority at the end of 2006.

To achieve these aims, the current study seeks to investigate the following:

1. The effect of the board size on firm performance;
2. The influence of non-executive members on firm performance;
3. The relationship between family board members and firm performance;
4. The role of royal family board members and how they affect firm performance;
5. The relationship between board committees and firm performance;
6. The relationship between managerial ownership and firm performance;
7. The influence of large block holders such as family or individual, government, foreign, financial or non-financial (corporations) ownership on firm performance; and
8. The concept of corporate governance in Saudi business environment among different stakeholders, in order to evaluate the current regulations and discuss improving and developing the current regulations.

1.4 RESEARCH QUESTIONS

From the defined aims and objectives, the main research questions in this study seek to answer the following questions:

1. How is corporate governance understood in the Saudi Arabian environment?
2. What is the level of compliance with corporate governance provisions of Saudi Arabia among Saudi Arabian listed companies?
3. What are the main obstacles to corporate governance, as applied through the new regulations of the Saudi capital market?
4. What are the main elements that corporate governance regulations need to improve and develop?
5. Is there any relationship between corporate governance mechanisms and firm performance? If so, what are its effects?

1.5 RESEARCH METHODOLOGY

The research methodology in this study uses two complementary empirical approaches: quantitative and qualitative. The study uses quantitative (secondary) data, which combines three different regression analyses: Ordinary Least Square (OLS), Two Stages Least Square (2SLS), Generalized method of moments (GMM). Also, this study uses qualitative data (semi-structured interviews) to achieve the research objectives. The quantitative data are analysed using statistical and econometrics tests which apply a number of techniques and models (OLS, 2SLS and GMM) to examine the relationship between corporate governance mechanisms and firm performance. Moreover, the researcher uses semi-structured interviews to improve understanding of the research phenomenon and problem. Triangulation provided by the two types of data will lead to improving understanding and explain better the answers to the research problem.

Table 1-1 The link between the research aims, objectives, questions and data collecting methods.

Research aims	Objectives	Research questions	Research methods
• To examine the relationship between corporate governance mechanisms and firm performance in the listed companies in the Saudi capital market;	1. The effect of the board size on firm performance; 2. The influence of non-executive members on firm performance; 3. The relationship between family board members and firm performance; 4. The role of royal family board members and how they affect firm performance; 5. The relationship between board committees and firm performance; 6. The relationship between managerial ownership and firm performance; and 7. The influence of large block holders such as family or individual, government, foreign, financial or non-financial (corporations) ownership on firm performance.	Is there any relationship between corporate governance mechanisms and firm performance? What are the effects?	Main: regression analysis Support: semi-structured interviews

Research aims	Objectives	Research questions	Research methods
• To explore the understanding of the concept of corporate governance in the Saudi Arabian environment among different stakeholders, and evaluate the current regulations of corporate governance, providing a comprehensive study of the nature and practice of corporate governance in Saudi Arabia after the regulations were issued by the Capital Market Authority at the end of 2006.	The concept of corporate governance in Saudi business environment among different stakeholders, with concern for and evaluation of current regulations and discussion of how to improve and develop the current regulations.	1. How is corporate governance understood in the Saudi Arabian environment? 2. What is the level of compliance with corporate governance provisions of Saudi Arabia among Saudi Arabian listed companies? 3. What are the main obstacles to corporate governance in the Saudi business as applied through the new regulations in the capital market? 4. What are the main elements that corporate	Main method: semi-structured interviews

Research aims	Objectives	Research questions	Research methods
		governance regulations need to improve and develop?	

1.6 THESIS STRUCTURE

This thesis is organised into ten chapters. The current chapter presents an introduction to the research. It provides a preamble of the research study, with concern for the research problem, objectives, questions, the importance of the study, and methodology that will be used.

Chapter Two contains a general review of corporate governance, which focuses on general definitions of corporate governance, an investigation of the corporate governance model with concern for Islamic corporate governance and the Shari'ya model. Also, this chapter discusses in more detail some of the corporate governance principles and codes such as OECD.

Chapter Three discusses the importance of the theoretical framework that describes and explains corporate governance. This chapter provides a brief description of the five theories behind the corporate governance mechanisms: agency theory, stewardship theory, stakeholder theory, transaction cost economics theory, and resource dependence theory. This chapter also provides a table comparing all of these theories to make understanding these theories easy.

Chapter Four highlights the literature review concerning the relationship between corporate governance mechanisms and firm performance. It will discuss the theory behind each variable, and review the prior empirical literature, divided into two sections. The first section offers the previous studies on developed countries, and the second section highlights the previous studies on emerging economies. It will then develop hypotheses on the basis of the review for each variable.

Chapter Five provides a background of the study setting, Saudi Arabia, by focusing on general information about Saudi Arabia's political, legal, and economic systems. Also, this chapter sheds light on monitoring bodies and the regulations and laws that set and regulate companies in Saudi Arabia. Furthermore, this chapter provides a description of the Saudi stock market, including its historical background and the development of the new Saudi capital market (Tadawul), with a focus on the corporate governance regulations in the Kingdom.

Chapter Six details and justifies the research methodology and data collection used in this study. This chapter also explains the two approaches used in the study—quantitative and qualitative—and is concerned with the study's triangulation methodology. In addition, it provides details about the data collection methods and the samples included in this study. Finally, this chapter provides a brief conclusion that summarises the research methodology.

Chapter Seven discusses the results of the study's quantitative data (secondary data from annual reports). It first provides results of the Ordinary Least Square (OLS) regressions after solving some problems related to the assumptions of the OLS. After that, this chapter provides the results of the two stage least square (2SLS) regressions that deal with endogeneity and causality and seeks to study the effect of corporate governance mechanisms between each other. It also seeks to examine the impact of firm performance Return on Assets (ROA) and Tobin’s Q (TQ) on corporate governance mechanisms. Finally, the chapter includes a dynamic generalized method of moments (GMM) regression. The GMM is applied to examine the potential endogeneity problem and detect unobserved heterogeneity and the dynamic relationship between corporate governance mechanisms and past performance.

Chapter Eight reports the findings of the interview data. The main objective of this chapter is to explore in greater detail the corporate-governance mechanisms in Saudi Arabia. It focuses on the relationship between corporate-governance mechanisms and firm performance.

Chapter Nine provides a general discussion that links and compares the findings of the secondary data analysis and the semi-structured interviews. The main objective of this chapter is to integrate the quantitative and qualitative analysis together and explain the findings of this study. Also, this chapter sheds light on how the qualitative data supports the findings from the quantitative data analysis (secondary data) and also explores some points not covered in the quantitative data.

Chapter Ten presents the conclusions of this thesis. It offers some recommendations for regulation, explains the limitations of the present study, and suggests some avenues for future research. Also, this chapter sheds lights on the study’s contributions to the knowledge of corporate governance and firm performance.

1.7 SUMMARY

This chapter presents the background to the research topic and the significance of the study. It provides the research problem, aims, and questions the study will develop. The chapter also highlights the methodology used in this thesis. Finally, it lays out the structure of the ten chapters in this thesis.

2 GENERAL REVIEW OF CORPORTE GOVERNANCE

2.1 INTRODUCTION

This chapter reviews the general features of corporate governance. It also provides general definitions of corporate governance with further explanations of different definitions. This chapter provides some reasons that give corporate governance more attention at the present. In addition, this chapter investigates the corporate governance model and provides a brief description of Islamic corporate governance. Moreover, this chapter discusses in greater detail corporate governance codes and reports with concern on the UK codes and the OECD principles of corporate governance. In the end, briefly summarises this chapter.

2.2 THE DEFINITIONS OF CORPORATE GOVERNANCE

The idea of corporate governance is ancient (Tricker, 2012). The history of the phrase *corporate governance* began at the end of 1980s (Tricker, 2012). Corporate governance contains two words: corporate and governance. According to the Oxford English Dictionary Online ("Corporate," 2012; "Government," 2012)[1] the word *corporate* means pertaining to or affecting the body, and the word *governance* means the action or a manner of governing. The phrase *corporate governance* is a new phenomenon in the financial surge or rise of the financial sectors of the last fifteen years (Mallin, 2007).

The phrase *corporate governance* has received more attention and become more important in the business world, particularly since the collapse of Enron and WorldCom. Corporate governance issues arise in corporations whenever there is a potential conflict of interest between internal and external stakeholders, for example between managers and shareholders (this is often referred to as the *agency problem*). Such conflicts are often associated with "asymmetric information," where the internal stakeholders have superior knowledge compared to that of the external stakeholders. In such a situation, transaction costs may lead to incomplete contracts or gaps (Hart, 1995) that make other mechanisms for resolving or avoiding conflicts necessary. Such mechanisms are collectively referred to as *corporate governance*. However, how can one arrive at a definition of corporate governance? A number of definitions for corporate governance are in use around the world.

Thus, there is no specific definition for describing corporate governance. There are generally many different definitions of corporate governance, all with different views about what it

[1] http://www.oed.com

means. The essential ideas of corporate governance have to do with a system of control in the company; the relationship between the board of directors, shareholders, and other stakeholders; and managing the company in accordance with the interests of shareholders and stakeholders (Hussain and Mallin, 2002).

There are two approaches to describing corporate governance. These approaches depend on two theories: the first approach depends on the agency theory. This approach is a simple pattern that describes corporate governance as a relationship between a company and its shareholders (Solomon, 2007). The second approach, which depends on the stakeholder theory, is a more widely used pattern that describes corporate governance as a web of relationships between a company and its stakeholders, such as employees, customers, suppliers, shareholders, and managers (Solomon, 2007).

In a 1992 report, Sir Adrian Cadbury provided a simple and general definition of corporate governance. Cadbury (1992, p.7) stated that, “corporate governance is the system by which companies are directed and controlled.” Cadbury (1992) focused on the board of directors and on how the members of the board can manage the company in the best way. Cadbury’s (1992) definition focused on the internal processes of the company and on the responsibility of the board of directors, which include setting the plan, devising a strategy, and supervising the management of the business. Also, this report included in the role of shareholders the appointing of directors and auditors to obtain and build a good structure of corporate governance.

In addition, Parkinson (1993) examined corporate governance under the interests of shareholders and how the managers work in the interests of shareholders. Parkinson (1993, p.159) defined corporate governance as “the process of supervision and control intended to ensure that the company’s management acts in accordance with the interest of shareholders.” This definition includes only shareholders. However, Parkinson’s (1993) definition implicitly involves managers’ setting up of methods and processes to control the company in accordance with shareholders’ interests.

Shleifer and Vishny (1997, p.737) defined corporate governance as “the ways in which the suppliers of finance to a corporation assure themselves of getting a return on their investment.” This definition focuses on the suppliers of finance, with respect to their confidence concerning their money and how the company can manage this money in the best way, in order to give the suppliers a good return on their money. Actually, the suppliers of money (creditors) are among those stakeholders who have some interests in the corporation, who invest money by supplying the company with funds, and expect to have good legal protection to receive good interest from the company.

The Organisation for Economic Co-Operation and Development (OECD) (2004, p.11) defined corporate governance as involving:

" 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 ".

This definition is broad because it looks at three entities: the board of directors, the shareholders, and other stakeholders. The OECD’s (2004) definition reflects the idea that when the company establishes a good relationship between these parts, such an action leads to improved performance, efficiency, and growth; also, investors become more confident in investing money.

Tricker (1984, p.6-7) gave a broad definition of corporate governance, stating that "the governance role is not concerned with the running of the business of the company per se, but with giving overall direction to the enterprise, with overseeing and controlling the executive actions of the management, and with satisfying legitimate expectation of accountability and regulations by interests beyond the corporate boundaries". This definition of corporate governance does not focus exclusively on shareholders, but looks at other company stakeholders and accountability, and how all stakeholders can receive equal treatment as well as their interests in the company.

Keasey and Wright (1993) defined corporate governance as a sum of the structure, process, cultures, and system that engender the successful operation of the organization. This definition describes corporate governance as a collective of structure, process, cultures, and systems working together to produce success and boost productivity. This definition reflects the idea that a company’s success depends on applying the standards and guidelines of corporate governance.

Solomon (2010, p.6) defined corporate governance as “the system of checks and balances, both internal and external to companies, which ensures that companies discharge their accountability to all their stakeholders and act in a socially responsible way in all areas of their business activity.” This definition incorporates checks and balances into the rules and principles of the company (internal) and its environments (external); it is a wider definition of corporate governance because its main ideas are to describe corporate governance. These ideas are:

1. Corporate governance is a system to manage and direct the company.
2. Corporate governance must look at the internal structure and the external environment.

Zheka (2005, p.452) said that "corporate governance delimits the distribution of the rights and duties amongst the different participants in the firm, and sets rules and procedures for making decisions. Corporate governance also provides structures through which aims and objectives are set, and through which monitoring is carried out". This definition looks at corporate governance as a distribution system for dividing rules and rights amongst stakeholders in order to make good decisions. However, good corporate governance must take into account all of the different participants who have a rightful decision in the company.

From all of these definitions, we can derive many various perspectives that describe corporate governance. Some of these definitions depend on agency theory to determine the relationship between shareholders and its company. However, some of the broader definitions of corporate governance consider stakeholders and external environments. Corporate governance contains rules, guidelines, systems, and standards to manage, balance, and control companies according to the interests of all stakeholders, to increase the performance and efficiency of the company. Also, corporate governance must consider the external environments, as well as establish good principles and guidelines that are commensurate with the environment, such as an Islamic environment. Lastly, a corporate governance system gives and provides more confidence to all stakeholders who deal with the company, not just shareholders.

2.3 THE IMPORTANCE OF CORPORATE GOVERNANCE

Corporate governance has grown rapidly in the last decade and has become an essential feature of companies (Hussain and Mallin, 2002). Recently, in the wake of corporate scandals afflicting such organisations as Enron, Tyco, Adelphi and others, corporate governance has begun receiving more attention (Harris and Raviv, 2008). Mallin (2007) outlined some reasons corporate governance has been given more importance:

1- Corporate governance is an appropriate system of control that helps to maintain the company's assets.
2- It prevents individuals from having too power and influence.
3- It is focused on the relationships among a company's management, board of directors, shareholders and other stakeholders.
4- It ensures the management and direction of the company will be in the best interests of shareholders and other stakeholders.
5- It gives investors more confidence by encouraging both transparency and accountability.

Good corporate governance is essential to attracting both foreign and new investment, particularly in developing countries (Mallin, 2007). Good corporate governance may result in efficiency gains, more output or value added (Love, 2011). Also, a corporate governance system is very important in protecting minority shareholders and creditors from risk (La Porta et al., 2000). However, the main objective of corporate governance is to ensure fairness to all stakeholders, not just shareholders, and this is to be attained through greater transparency and accountability (Hasan, 2009).

Claessens (2006) outlined five reasons corporate governance is important for economic development in many countries:

1- Privatisation: The importance of corporate governance is increased because the firm has gone to the public market to seek more capital.
2- Liberalisation: Trade liberalisation and the opening up of financial markets leads to more capital from various countries; this makes good corporate governance more important.
3- The results of increasing firm size, the growing role of financial intermediaries, and the growth of institutional investors in many countries have increased the need for a good corporate governance system.

4- The deregulation and reform of many firms and companies, along with new institutional arrangements, have led to the need for a better corporate governance system.
5- More international financial integration results in good corporate governance.

In addition, Claessens (2006) mentioned that the application of corporate governance can have a positive effect on growth and development via several related channels, as follows:

1. Increased access to external financing by firms that may encourage more foreign and local investors to invest in their listed companies, leading to enhanced growth and more employment.
2. Lower capital costs and associated higher firm values attracting investment that leads to growth and development.
3. Better operational performance through better allocation of resources and better management, enhancing growth and development.
4. The existence of good practices in corporate governance, reducing financial crises and enhancing growth and development; this is an opposite relationship between financial crises and growth.
5. The concept of good corporate governance practices creates a better relationship with all stakeholders, which helps to improve social and labour relationships and areas such as environment protection.

2.4 CORPORATE GOVERNANCE MODELS

There are two main models of corporate governance, the first being the shareholder model, or the market-based system, or what some scholars refer to as the outsider model, and as the second being the stakeholder model, also known as the European model, which is an insider-dominated system. These models are the most widespread models being used in the most countries. However, there is a new model that describes corporate governance in the Islamic view: the Islamic model looks at all stakeholder groups from the point of view of Shari'ya law.

Firstly, the shareholder model of corporate governance, also known as the market-based system, the Anglo-Saxon model, or the principal agent model, is used mainly in the United States and the United Kingdom and is an outsider-dominated system (Prowse, 1994; Hasan, 2009; Solomon, 2007). The aim of the shareholder model is to maximise shareholder wealth (Maher and Andersson, 2000). Maher and Andersson (2000) also mentioned that the problem of corporate governance under this model arises from the principal-agent relationship because the interests of the principals may differ from those of the agents. Another problem that is associated with the principal-agent problem is incomplete contracts, which lead to transaction costs (Hart, 1995).

Secondly, the stakeholder model of corporate governance, also known as the European model, is an insider-dominated system (Solomon, 2007; Hasan, 2009). The stakeholder model is used by a majority of European countries including Germany, France, and Greece (Hasan, 2009). The stakeholder model is relationship-based because of the close relationship between companies and their dominant shareholders (Solomon, 2007). The main objective of this model is to consider social responsibility for all stakeholder interests rather than only the shareholders' interests (Maher and Andersson, 2000). However, Solomon (2007) highlighted some problems with this model. The results of the close relationship between owners and managers seem to reduce the agency problem and also seem to be a positive characteristic because they are the same people (Solomon, 2007). However, Solomon also mentioned that the low level of separation between ownership and control can lead to abuses of power (2007). In addition, she indicated that there is little transparency and accountability, so minority shareholders may not be able to obtain enough information about the company's operations (2007).

Solomon (2007) explained the main differences between the shareholder model (outsider-dominated) and the stakeholder model (insider-dominated) with the following table:

Table 2-1 Comparison between stakeholder and shareholder models

Insider (stakeholder model)	**Outsider (**shareholder model)
Firms owned predominantly by insider shareholders who also wield control over management	Large firms controlled by managers but owned predominantly by outside shareholders
System characterized by little separation of ownership and control such that agency problems are rare	System characterized by separation of ownership and control, which engenders significant agency problems
Hostile takeover activity is rare	Frequent hostile takeovers acting as a disciplining mechanism on company management
Concentration of ownership in a small group of shareholders (founding family members, other companies through pyramidal structures, state ownership)	Dispersed ownership
Excessive control by a small group of 'insider' shareholders	Moderate control by a large range of shareholders
Wealth transfer from minority shareholders to majority shareholders	No transfer of wealth from minority shareholders to majority shareholders
Weak investor protection in company low	Strong investor protection in company low
Potential for abuse of power by majority shareholders	Potential for shareholder democracy
Majority shareholders tend to have more 'voice' in their investee companies	Shareholding characterized more by 'exit' than by 'voice'

Source: Solomon (2007)

In addition, Cernat (2004) summarised the different labour-related and capital-related aspects of the two models of corporate governance in the table below.

Table 2-2 Aspects of labour-related and capital-related of two models of corporate governance

Aspects	Anglo-Saxon	Continental
Labour-related		
Co-operation between social partners	Conflictual or minimal contract	Extensive at national level
Labour organizations	Fragmented and weak	Strong, centralized unions
Labour market flexibility	Poor internal flexibility; high external flexibility	High internal flexibility; lower external flexibility
Employee influence	Limited	Extensive through works councils and co-determination
Capital-related		
Ownership structure	Widely dispersed ownership; dividends prioritized	Banks and other corporations and major shareholders; dividends less prioritized
Role of banks	Banks play a minimal role in corporate ownership	Important both in corporate finance and control
Family-controlled firms	General separation of equity holding and management	Family ownership important only for small- and medium-sized firms
Management boards	One-tier boards	Two-tier boards
Market for corporate control	Hostile takeovers are the 'correction mechanisms' for management failure	Takeovers are restricted
Role of stock exchange	Strong role in corporate finance	Reduced role

Source: Adapted from Rhodes and van Apeldoorn (1997) (Cited in Cernat, 2004)

Thirdly, the Islamic model of corporate governance is a new model that delineates corporate governance from the Islamic point of view. There is little literature that explains and describes corporate governance in the Islamic view. The Islamic corporate governance model is very similar to the stakeholder model of corporate governance, tying Shari'ya law objectives to the stakeholder model of corporate governance (Bhatti and Bhatti, 2009). According to Hasan (2009, p. 286), “the Islamic corporate governance based on the stakeholder-oriented model is preoccupied by the two fundamental concepts of Shari'ya principles of property rights and contracted frameworks”. Corporate governance in the

Islamic view considers all stakeholder groups based on Shari'ya, which is related to the ethical values of Islam such as fairness and truthfulness (Kasri, 2009).

Bhatti and Bhatti (2009) stated that the model of Islamic corporate governance:

1- is based on the principle of property rights and contracted frameworks;
2- is governed by Islamic law, or Shari'ya; and
3- includes all stakeholders.

In accordance with these principles, Islamic corporate governance is a comprehensive model of corporate governance because it considers the shareholders and all stakeholder groups according to ethical standards set by Islam. Hasan (2009) provided a table that explained the difference between three models of corporate governance: the Anglo-Saxon model (shareholders), the European model (stakeholders), and the Shari'ya model (Islamic corporate governance):

Table 2-3 The difference between Anglo-Saxon, European and Shari'ya models

Aspects	**Anglo-Saxon (shareholder model)**	**European (stakeholder model)**	**Shari'ya Model**
Episteme	Rationalism and Rationality	Rationalism and Rationality	Tawhid
Objective:			
Rights and Interests	To protect the interests and rights of the shareholders	To protect the interests and rights of the community in relation to the corporation	To protect the interests and rights of all stakeholders but subject to the rules of Shari'ya
Corporate goal	Shareholders controlling managers for the purpose of shareholders' profit	Society controlling corporation for the purpose of social welfare	Acknowledging being profit motive oriented while being in balance with the Shari'ya objectives and principles
Nature of	Management	Controlling	Concept of

Management	dominated	shareholder dominated	vicegerency and Shura
Management Board	One-tier board	Two-tier board	Two-tier board. Shari'ya board as the ultimate governance
Capital-related and Ownership Structure	Widely dispersed ownership; dividends prioritized	Bank and other corporations are major shareholders; dividends less prioritized	Shareholders and depositors or investment account holders

Source: Hasan (2009)

Abu-Tapanjeh (2009) compared the Islamic corporate governance principles with the OECD principles of corporate governance shown in this table:

Table 2-4 Comparison between Islamic corporate governance and OECD principles

	OECD Principles and Annotation	Islamic Principles
1- ***Ensuring the basis for an effective corporate governance framework***		
	• Promotion of transparent and efficient markets with rule of law and division of responsibilities	• Promotion of business within ethical framework of Shari'ya • Belief in profit and loss • Primacy of justice and social welfare with social and spiritual obligations • Prohibition of interest
2- ***The rights of shareholders and key ownership functions***		
	• Basic shareholder rights • Participation in decision-making at the general meetings • Structure and arrangement markets for corporate control • Ownership rights by all shareholders, including institutional shareholders • Consultative process between shareholders and institutional shareholders	• Property as a trust from God • Sole authority is God • Society as stakeholders • Accountability not only to stakeholders but also to God, the ultimate owner

3- ***The equitable treatment of shareholders***		
	• Protection of minority and foreign shareholders	• Values of justice and fairness Equitable distribution of wealth to all stakeholders and disadvantaged members in the form of *Zakat* and *Sadqa* • Social and individual welfare with both spiritual and moral obligations • Sensation of equality
4- ***The role of stakeholders in corporate governance***		
	• Creating wealth, jobs, and sustainability of financially sound enterprises	• Islamic accountability to *Falah* and social welfare orientation • Haram/Halal dichotomy in transaction • Social and individual welfare both spiritually and materially • Consideration of whole community
5- ***Disclosure and transparency***		
	• Matters regarding corporations • Financial situations	• Shari'ya accountability and compliance • Socio-economic objectives related to firms' control and

	• Performance, ownership, and governance	accountability to all stakeholders • Justice, equality, truthfulness, and transparency • Wider accountability with written as well as oral disclosure
6- ***The responsibilities of the board***		
	• Strategic guidance • Monitoring of management • Accountability to company and stakeholders	• Accountability not only to the company, board, or stakeholders but also to Allah, the ultimate authority, who leads to welfare and success • Holistic and integrative guidance • Negotiation and co-operation • Consultation and consensus-seeking for each decision with stakeholders

Source: Abu-Tapanjeh(2009)

In conclusion, the corporate governance system in Saudi Arabia combines the Anglo-Saxon and European systems with a slight interjection of Islamic style. For example, a number of listed companies are owned by founding family members and their governance reflects the insider model of the European system (Solomon, 2007). The Saudi corporate governance system differs from the European system, because it solely maintains a one-tier board (e.g., the Anglo-Saxon system with a Shari'ya board consultant to discuss Islamic jurisprudence issues). In addition, the Kingdom of Saudi Arabia is a Muslim country. Therefore, it seeks to protect the interests and rights of all stakeholders— not just shareholders, but also those who are also subject to the rules of Shari'ya (Hasan, 2009).

2.5 THE CORPORATE GOVERNANCE CODES

A large number of massive corporate collapse crises resulting from a weak system of corporate governance codes has drawn increased attention to the need to improve, develop and reform such regulations (Solomon, 2007). In addition, a number of reasons, including financial scandals, justify the existence of these codes. Scandals involving Enron and WorldCom led to reforms in corporate governance regulations (Mallin, 2007). Another reason for reform is to protect the rights of outsider investors, including both shareholders and creditors (La Porta et al., 2000). Additionally, the lack of transparency and inadequate disclosure increase the need to strengthen corporate governance regulations (Liew, 2006). According to Zattoni and Cuomo (2008), the two main purposes of good corporate governance codes are to compensate for deficiencies in legal protections for investors and to enhance not only the efficiency of governance but also the legitimacy of national companies in the global financial market.

The 1990s saw growing interest in reforming, revising and creating regulations to address new areas in corporate governance (La Porta et al., 2000), and this interest continued into the 2000s. Each country has a different legal system, cultural background, business forms and ownership structure, which leads to the creation and reform of different versions of corporate governance (Mallin, 2007). The development of corporate governance regulations, codes and guidelines has often been driven by financial scandal, corporate collapses and other financial crises (Mallin, 2007). These regulations have positive impacts upon company activities, capital costs, growth, firm performance and the development of capital markets (Martynova, 2006).

Corporate governance regulations, guidelines and codes have been issued by various bodies, including investment communities, academics, stock exchange bodies and investment representative groups (Mallin, 2007). For example, in Saudi Arabia, the board of the Capital Market Authority issued corporate governance regulations in 2006, while in Bahrain, the Ministry of Industry and Commerce, Central Bank of Bahrain and National Corporate Governance Committee jointly developed a corporate governance code (Corporate Governance Code, Kingdom of Bahrain, 2010). The United Kingdom (UK) has used many codes for corporate governance, including the Cadbury, Greenbury and Hampel reports. Each code addressed a specific issue in the corporate governance mechanisms. In 2008, the Financial Reporting Council in the UK issued the Combined Code on Corporate Governance bringing together the recommendations of the earlier reports to increase confidence in financial reporting (Combined Code on Corporate Governance, 2008). Most of these codes are based on a comply-or-explain philosophy, under which compliance with their principles is not mandatory but disclosure of compliance or non-compliance is (MacNeil and Li, 2006). For example, the UK’s Combined Code (2003) required that companies follow the full disclosure requirements and state whether they have complied with the code’s provisions or explain why not (Mallin, 2007).

The following table shows when countries and organisation first issued a corporate governance code.

Table 2-5 The first issued of corporate governance codes among countries

Year	Country
1992	UK
1994	Canada and South Africa
1995	France, Australia and Pan-Europe
1996	Spain
1997	United States of America, The Netherlands and Japan
1998	Belgium, Germany, India, Italy and Thailand
1999	The Commonwealth, Hong Kong, Greece, ICGN, Ireland, Mexico, OECD, Portugal and South Korea
2000	International comparison of corporate governance: Guidelines and codes of best practices in developing and emerging markets, Denmark, Indonesia, Malaysia, Romania and the Philippines
2001	Brazil, China, Czech Republic, Malta, Peru, Singapore and Sweden

2002	Austria, Cyprus, Hungary, Kenya, Oman, Pakistan, Poland, Russia, Slovakia, Switzerland and Taiwan
2003	Finland, Latin America, Lithuania, New Zealand, Nigeria, Republic of Macedonia, Turkey and Ukraine
2004	Argentina, Bangladesh, Iceland, Mauritius, Norway and Slovenia
2005	Jamaica and Latvia
2006	Bosnia–Herzegovina, Egypt, Estonia, Lebanon, Luxembourg, The Netherlands Antilles, Saudi Arabia, Sri Lanka, Trinidad and Tobago and the United Nations
2007	Bulgaria, Colombia, Jordan, Kazakhstan, Moldova, Mongolia and the United Arab of Emirates
2008	Albania, Morocco, Qatar, Serbia and Tunisia
2009	Algeria, Croatia, Georgia and Montenegro
2010	Armenia, Bahrain, Baltic States, Ghana, Malawi and Yemen
2011	Azerbaijan and Guernsey
2012	Republic of Maldives
2013	Barbados

Source: Adopted from European Corporate Governance Institute (2013)[2]

This study examines two codes of corporate governance, the UK codes and the OECD's principles of corporate governance. The UK's codes are addressed first, because in 1992, this country became the first to establish such codes. Additionally, a number of countries, including Taiwan, based their corporate governance codes on the UK's (Solomon et al., 2003). The publication of the Cadbury Report, the earliest UK report on corporate governance, prompted many countries to try to improve corporate governance practices (Al-harkan 2005). Next, this research addresses the OECD's principles of corporate governance, because they influenced the Saudi Arabian corporate governance codes, most of which are based on or are similar to those of the OECD (Alshehri, 2012).

2.5.1 CORPORATE GOVERNANCE IN THE UNITED KINGDOM

The UK is one of the most developed countries in the world and has a well-developed market with various investor bases, including institutional and individual investors and financial institutions (Mallin, 2007). Jones and Pollitt (2001) outlined the main stages of the process by which committees charged with establishing corporate governance have operated:

[2] http://www.ecgi.org/codes/all_codes.php

1. Initial interest: In this stage, when an influence group (such as the Confederation of British Industries) believes that a problem exists, this belief supplies evidence of significant, initial interest in dealing with apparent governance problems.
2. Formation of the committee: The committee chair and members are appointed. They should have enough experience to solve these problems.
3. Terms of reference: The committee receives the official reference terms and redefines or elaborates upon them as it deems necessary.
4. Deliberation: The how and wherefores of the principal workings of the committee take place, including writing the draft report and collecting and considering comments on the draft report.
5. Compilation of the final report: The final report is put together, and the influences on it noted in the conclusion of the draft report.
6. Content of the final report: Details are added to the final report, and the main conclusion of the committee's report written.
7. Presentation of the final report: The committee releases the final report to the public.
8. Debate: This stage is related to the previous one. The most influential shapers of the debate are identified.
9. Implementation: In the final stage, an agency or organization takes responsibility for implemented the recommendations in the report.

The development of corporate governance in the UK can be represented by the Combined Codes, published in 2006 by the Financial Reporting Council (Mallin, 2007). Mallin (2007) explains the development of corporate governance in the UK, as illustrated in Figure 2-1 below.

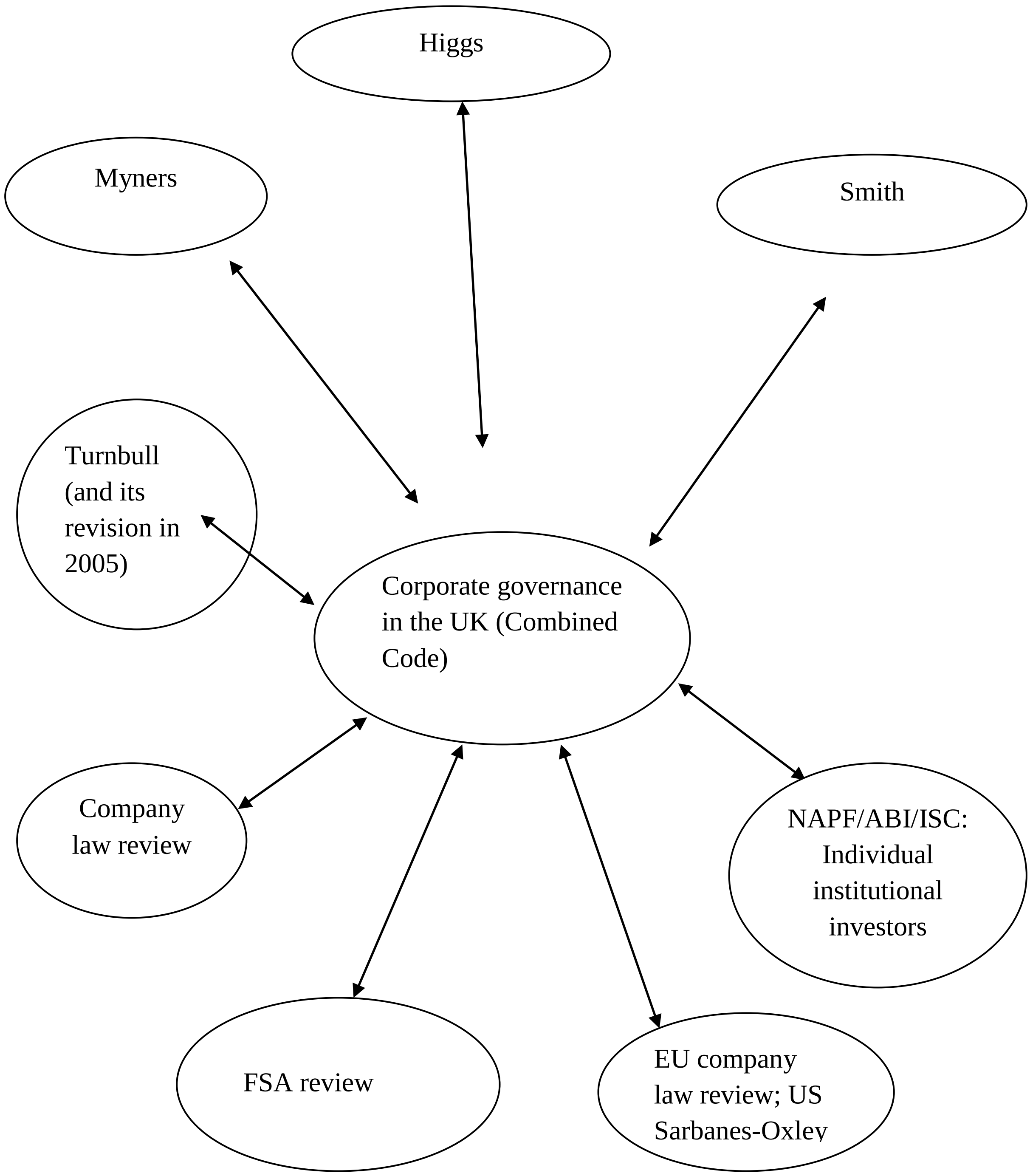

Figure 2-1 Development of corporate governance in the UK

According to Mallin (2007), the original Combined Code on Corporate Governance issued in 1998 consisted of three main reports: the Cadbury, Greenbury and Hampel reports. Figure 2-1 shows the various influences on the Combined Code. Within the first influence, four main reports describe specific areas of corporate governance: the Turnbull (internal control), Myners (institutional investment), Higgs (the role of non-executive directors' effectiveness) and Smith reports (audit committee). The second influence stems from institutional investors, such as the National Association of Pension Funds (NAPF), Association of British Insurers (ABI) and Institutional Shareholders' Committee (ISC). The third influence is the UK legal system of corporate governance, including company law. The fourth influence comes from external factors, such as the European Union (EU) review of company law and the United States' Sarbanes-Oxley Act.

2.5.1.1 The Cadbury Report (1992)

The Cadbury Report is the first published attempt to formalize the best practices of corporate governance (Solomon, 2007). Following a sustained period of economic growth, especially 1987–88, with significant increases in gross domestic product (GDP) growth and asset prices, 1990 and 1991 saw high inflation and negative growth (Jones & Pollitt, 2001). These economic conditions led to spectacular corporate collapses, including of those of Coloroll and Robert Maxwell and the $8-billion failure of the Bank of Credit and Commerce International (BCCI) (Jones & Pollitt, 2001). Public concern about failures of corporate governance revealed by these collapses has since made corporate governance a more important topic of discussion among policymakers (Solomon, 2007).

In May 1991, the Financial Reporting Council, London Stock Exchange and accountancy profession established the Cadbury Committee to address the financial aspects of corporate governance (Cadbury Report, 1992). The Cadbury report (1992) states two main reasons for the committee's establishment:

1. Low level of confidence in financial reporting and audit reports' ability to provide safeguards: The absence of a clear framework for accounting standards was seen as leading to weak control and low confidence.
2. The failure of major companies in the UK due to a weak corporate control system: These failures made it necessary to attend to clarifying responsibilities and raising

standards, and the report was seen as a means of encouraging best corporate-governance practices.

After the first draft of the report was released for public comment on May 27, 1992, the committee received more than 200 written responses to its proposals. The majority supported the committee's approach, and some led to modifications in the final draft of the report.

The Cadbury Report covered three general areas: the structure of boards of directors and its responsibility to adopt a code of best practices; the roles of the chairperson, non-executive directors, board and company secretary; and board remuneration and best practices for some committees. The report also offered several recommendations for auditors' role. The last section dealt with the rights and responsibilities of shareholders, including institutional shareholders. Jones and Pollitt (2004, p. 168) described the report as "a model of how to conduct a corporate governance investigation" and identified a number of desirable features:

1. Sir Adrian Cadbury was a good, visionary chairperson who energetically promoted his suggestions and recommendations.
2. The Cadbury Committee reflected the main stakeholders.
3. The issuing of a draft report was followed by consultation.
4. The final report included recommendations that were accepted widely.

2.5.1.2 The Greenbury Report (1995)

A second corporate governance committee was created to address the issue of directors' remuneration (Solomon, 2007). The Confederation of British Industries formed the Study Group on Directors' Remuneration (CBI) in January 1995 in response to public and shareholder concerns about the pay and other remuneration for company directors in the UK (Greenbury, 1995). The Greenbury Report included details about directors' remuneration, discussed disclosure and approval provisions and focused on PLC directors. The Greenbury Report (1995, para. 1:15) states that "the key to encouraging enhanced performance by directors lies in remuneration packages which link rewards to performance by both the company and individuals and align the interests of directors and shareholders in promoting the company's progress". According to Solomon (2007), the primary aim of the Greenbury Report was to provide a means to balance directors' salaries with their performance.

2.5.1.3 The Hampel Report (1998)

The Hampel Committee on Corporate Governance was established in November 1995 by the chairperson of the Financial Reporting Council, Sir Sydney Lipworth (Hampel, 1998). The committee issued a new report based on a review of the recommendations of the Cadbury and Greenbury committees and the implementation of the financial aspects of both corporate governance and directors' remunerations (Mallin, 2007; Solomon, 2007). The Hampel Committee report, published in 1998 (Mallin, 2007), discussed five major topics: the principles of corporate governance, the role of directors, directors' remuneration, the role of shareholders, accountability and audits. A general introduction and a summary of conclusions and recommendations placed these topics in context. The report's content was highly similar to that of the Cadbury and Greenbury reports.

The Hampel Report, though, did comment on matters with which the Cadbury and Greenbury reports did not deal and took a different view in some areas. For example, the Hampel Report did not address the company secretary's role in corporate governance, which the Cadbury Report discussed fully. While large, listed companies fully implemented both the Cadbury and Greenbury reports, smaller companies did so for most provisions but found it hard to comply with some. The Hampel Committee thoughtfully addressed this problem and distinguished between the governance standards expected of larger and of smaller companies.

The Hampel Report's most important contribution was its emphasis on avoiding a prescriptive approach to corporate governance and stipulating that companies and shareholders need to avoid taking a "box-ticking" approach to corporate governance. Instead, the Cadbury Report stressed the importance of focusing on the spirit of corporate governance reform (Solomon, 2007). The box-ticking approach does not account for the variety of circumstances and experiences among companies and even within the same company. This approach assumes that the roles of the chairman and the chief executive officer (CEO) should never be combined and that there is an ideal, minimum number of non-executive directors and maximum term for executive directors (Hampel, 1998).

2.5.1.4 The Turnbull Report (1999)

The Institute of Chartered Accountants in England and Wales established the Turnbull Committee to provide guidance for listed companies implementing the code's internal control requirements (Turnbull, 1999). The initial impetus to create the committee came from the lack of an adequate internal control system during high-profile corporate failures in the late 1980s. In addition, the Cadbury Report had not addressed in detail the effectiveness of internal control (Jones & Pollitt, 2001). These codes' objectives were to establish best business practices whereby internal control could be embedded in the business process by which a company pursues its objectives, to enable each company to apply these codes in a manner appropriate for its particular circumstances and to remain relevant in the continually changing business world (Turnbull, 1999).

The creation of the Turnbull Committee reflected the importance of specific codes that address internal control systems, while the report itself highlighted the need for internal controls, such as safeguarding shareholders' investments and company assets, ensuring the reliability of internal and external reporting and complying with law and regulations. The Turnbull Report confirmed that a board of directors is responsible for reviewing and assessing the effectiveness of a company's system of internal control.

2.5.1.5 The Higgs Report (2003)

The Higgs Report addressed the role and effectiveness of non-executive directors. Solomon (2007) explained the main reason for the establishment of this committee: The Enron scandal spurred the UK to re-evaluate corporate governance issues, such as the role and effectiveness of non-executive directors.

2.5.1.6 The Combined Code

Published in 1998, the Combined Code combined the recommendations of the Cadbury, Greenbury and Hampel reports. Its two main sections covered companies and institutional investors (Mallin, 2007). In July 2003, after also reviewing the Higgs Report, the Financial Reporting Council issued a new draft of the Combined Code on Corporate Governance. Solomon (2007) identified the primary reforms of the new code: At least half of a board of directors should be independent non-executives, a CEO should not be the chairperson of the same company, and the chairperson should be independent. The most recent revision, made in 2003, discussed non-executive directors. In 2006, an update to the Combined Code included these main changes (Mallin 2007): allowing chairpersons to serve on the remuneration committee, where they are considered independent; providing a vote-withheld option on proxy appointment forms to enable shareholders to indicate that they wish to withhold their vote; and recommending that companies publish online the details of proxies lodged at general meetings at which votes are taken based on a show of hands.

2.5.1.7 The UK Corporate Governance Code

The first version of the corporate governance code in the UK was produced in 1992 by the Cadbury Committee (the UK Corporate Governance Code, 2010). The UK Corporate Governance Code dictates good practices by outlining five main principles that include leadership, effectiveness, accountability, remuneration, and relations with shareholders. Companies that are listed in the UK are required to report on how they have applied these principles and either to confirm that they have complied with the Code's provisions or, where they have not, provide an explanation (i.e., comply or explain) (Financial Reporting Council, 2013). The new Code applies to accounting periods that began on or after 29 June 2010. Further, as a result of the new Listing Regime that was introduced in April 2010, the new Code also applies to all companies with a Premium Listing of equity shares, regardless of whether they are incorporated in the UK or elsewhere (the UK Corporate Governance Code, 2010). The Code that was revised in September 2012 follows a consultation exercise that sought views on whether to amend the UK Corporate Governance Code and the associated Guidance on Audit Committee (Financial Reporting Council, 2013).

2.5.2 OECD PRINCIPLES OF CORPORATE GOVERNANCE

The international, Paris-based Organisation for Economic Cooperation and Development (OECD) has 29 member countries (Solomon, 2007). The OECD has created advanced guidelines and an agenda for corporate governance that consider how it can affect competition. In addition, these guidelines give a vital role to investment institutions; through the principles, such companies can utilize practices that increase and sustain the value of their investments. The OECD principles also give guidance to boards trying to determine how to improve the performance of their companies. The main purpose of the OECD is to assist OECD and non-OECD governments in evaluating and improving the legal, institutional and regulatory framework of corporate governance and to give guidance and suggestions to stock markets, investors, corporations and other parties that have a role in developing good corporate governance (OECD Principles of Corporate Governance, 2004). These principles focus on publicly traded companies, both financial and non-financial, and are extremely important tools to improve corporate governance in non-traded companies.

2.5.2.1 History of OECD's Approach to Corporate Governance

At a council meeting in April 1998, the OECD ministry established its principles of corporate governance (OECD Principles of Corporate Governance, 2004). Several institutional elements—national governments, relevant international organisations and certain private sector players—contributed to the creation of these principles. At a 2002 ministerial-level OECD council meeting, the OECD Steering Group on corporate governance, World Bank, Bank of International Settlement (BIS) and International Monetary Fund (IMF) conducted a survey among OECD countries to assess and improve the principles of corporate governance (OECD Principles of Corporate Governance, 2004).

2.5.2.2 Definition

The OECD principles provide guidance and recommendations for stock market investors, corporations and other important parties involved in shaping corporate governance. The OECD believes that corporate governance is an important factor in increasing economic efficiency and growth and investor confidence. The OECD defines corporate governance as

> 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. Good corporate governance should provide proper incentives for the board and management to pursue objectives that are in the interests of the company and its shareholders and should facilitate effective monitoring. (OECD Principles of Corporate Governance, 2004, p. 11)

The OECD states that corporate governance depends on the legal, regulatory and institutional environment (OECD Principles of Corporate Governance, 2004). Influenced by other factors including business ethics, the framework is designed to solve problems resulting from the separation of ownership and control. The OECD states factors that can affect corporate governance (OECD Principles of Corporate Governance, 2004):

1- Controlling shareholders
2- Institutional investors
3- Creditors

4- Employees and other stakeholders

The main areas addressed by the OECD principles are as follows (OECD Principles of Corporate Governance, 2004).

1- Ensuring the Basis for an Effective Corporate Governance Framework

The corporate governance framework should enhance and support transparent and efficient markets. The OECD suggests that, to build a strong, effective corporate governance framework, the focus should be on increasing improvements to economic performance. Additionally, this framework should be transparent, enforceable and compatible with the rule of law. Under strong corporate governance, the division of responsibilities is clear. An effective corporate governance framework also includes supervisors and regulators who have the authority to do their duties in a professional, objective manner.

2- Rights of Shareholders and Key Ownership Functions

An important principle held by the OECD is that the corporate governance framework should protect shareholders' rights to:

- Secure methods of ownership registration
- Buy, sell or transfer shares
- Receive relevant and timely information about the company
- Vote in general shareholder meetings
- Elect board members
- Share in the profits with liability limited by the number of shares investors own

In addition, the OECD has discussed points related to shareholders meetings and voting procedures. Shareholders should know the location, date and agenda of a meeting far enough in advance to decide if they will attend. When shareholders can be present at meetings, they should ask board members questions about financial reporting and the annual external audit report. Shareholders can also elect and nominate board members, which the OECD supports as a basic right. To elect a suitable member, shareholders should be provided full disclosure about each candidate's experience and background during the nomination process. As well, the board's remuneration policy should be disclosed because, according to the OECD, it is important to know the specific link between remuneration and company performance. As well, organization rules and regulations governing acquisitions and mergers should be clearly articulated and disclosed to keep investors informed about their rights.

3- Equitable Treatment of Shareholders

This principle is important in building any framework for corporate governance because it ensures the equitable treatment of all shareholders, including minority and foreign shareholders. This principle mandates the following points:

- All shareholders at the same stage should be treated equally.
- Investor trading and abusive self-dealing should be prohibited. This situation occurs when investors have a close relationship with a member of the board of directors or a manager.

4- Stakeholders’ Role in Corporate Governance:

A corporate governance framework should address the rights of stakeholders as established by law or general agreement. Stakeholders play an important role in corporate governance because they contribute valuable resources for building competitive, profitable companies. In addition, the law protects stakeholders’ benefits. When their interests or rights are violated, they should obtain effective redress.

Employees are stakeholders. The OECD recommends developing mechanisms to improve employee performance, which invests in the corporation by increasing employees’ skills and knowledge. These stakeholders are a pillar of the corporate governance framework and should have timely access to relevant information. Creditors are another important stakeholder whose rights are also protected by the corporate-governance framework.

5- Disclosure and Transparency

The corporate governance framework should ensure that all important, accurate information about the corporation, including financial reports, financial performance and ownership structure, is disclosed in a timely. A strong disclosure policy is an important basis for increasing transparency, attracting money and capital and building confidence in the capital market. Low transparency, on the other hand, can decrease market value and crate a lack of confidence. The OECD recommends that disclosure include the following:

- The company's financial position and operating results
- Company objectives and policies
- Ownership structure and the rights of ownership
- Remuneration policy for board members
- Any foreseeable risk factors

6- Responsibilities of the Board

- The corporate governance framework gives strategic guidance to corporations.
- The board of directors should act in the interests of the company, shareholders and employees.
- The board should treat all shareholders fairly.
- The board should apply high ethical standards.
- The board should perform the following functions:

- ➢ Review and guide corporate strategy
- ➢ Assess governance practices' effectiveness and make changes
- ➢ Clearly disclose and communicate information
- ➢ Ensure the integrity of financial reports
- ➢ Manage and prevent conflicts of interests among management, board members and shareholders

Solomon (2007) stated that the OECD principles are one of the most significant influences on corporate governance reform globally and form the basis for many international codes, acting as an umbrella for many corporate-governance regulations around the world (Steger and Amann, 2008, as cited in Alshehri, 2012). The OECD principles seek to set minimal, acceptable standards and codes for the best practices of corporate governance, protecting the market and shareholders (Alshehri, 2012).

2.6 SUMMARY

This chapter provided a general review of corporate governance concepts. Many aspects of corporate governance were discussed, such as definitions and models. Also, the corporate governance codes were investigated in greater detail especially in the UK and the OECD principles. However, the recommendations of corporate governance codes are based on ideas about how companies ought to be governed, which are derived from, or influenced by, various theories. Also, theories have been developed to try to explain the actual governance practices that are observed. The next chapter will a theoretical framework of corporate governance.

3 THEORETICAL FRAMEWORK

3.1 INTRODUCTION

There are different theories that describe and explain the mechanisms of corporate governance. This chapter will concern itself with five different theories of corporate governance: agency theory, stewardship theory, stakeholder theory, transaction cost economics, and resource dependence theory. All of these theories have a specific view and objectives that reflect corporate governance mechanisms. Before starting a review of the empirical literature on corporate governance (see Chapter 4), we need to understand the theoretical framework that explains the relationship between corporate governance mechanisms and firm performance. At the end of this chapter, we will provide a comparison of all of these theories in table format.

3.2 AGENCY THEORY

Agency theory is one of the theories most widely employed by researchers and scholars in business disciplines like accounting, marketing, finance, and economics (Eisenhardt, 1989). Most of the research concerned with corporate governance applies agency theory in their studies (e.g. Adams and Mehran, 2003; Ben-Amar and Andre, 2006; Haniffa and Hudaib, 2006; Al-Saidi, 2010; Bianco and Casavola, 1999; Agrawal and Knoeber, 1996; Shleifer and Vishny, 1997; Brudney, 1985). Agency theory concerns and describes the relationship between shareholders and mangers. Ross (1973, p. 134) stated, "an agency relationship has arisen between two (or more) parties when, one designated as the agent, acts for, on behalf of, or as representative for the other, designated the principal, in particular domain of decision problem".

According to Cadbury (2002), the agency problem has existed as long as there has been separation of ownership and control. Agency was first analysed in the 18th century by Adam Smith (1776), who explored the problem from the perspective of how to separate corporate ownership and control. Adam Smith (1776, as cited in Cadbury, 2002, p. 4) held that “the directors of such companies however being the managers rather of other people’s money than of their own, it cannot well be expected that they should watch over it with the same anxious vigilance which the partners in private copartnery frequently watch over their own … Negligence and profusion, therefore, must always prevail, more or less, in the management of the affairs of such a company”.

Berle and Means (1932), who provided an explanation of the relationship between company managers and investors in the United States, observed that large corporations were generally run by managers who had relatively small ownership interests in the firms they managed. The modern formulation of agency theory is provided by Jensen and Meckling in their paper titled *'Theory of the firm: Managerial behaviour, agency costs and ownership structure'* that was published in 1976. Agency relationship is defined by Jensen and Meckling (1976, p. 308) as "a contract under which one or more persons (the principals) engage another person (the agent) to perform some service on their behalf which involves delegating some of the decision making authority to the agent".

Agency theory attempts to address two main problems that can arise in a company that stem directly from the agency relationship. First, given that a conflict of interest in goals and strategies can occur between agents and principals, and since it can be difficult for the principals to verify exactly what the agent is doing (this is sometimes referred to as the 'moral hazard' problem), how can the agent be provided with incentives to act in the interest of the principal? How, alternatively, can structures be established that prevent the agent from acting against the interest of the principal? (Eisenhardt, 1989). The second problem is encountered when the agent and the principals have different beliefs (this is sometimes referred to as the 'adverse selection' problem); for example, when there is a conflict about what constitutes acceptable risk (Eisenhardt, 1989). La Porta et al. (2000) mentioned another problem related to conflicts of interest that arise among different shareholders rather than between managers and shareholders. This problem arises when controlling shareholders can apply and act on policies that benefit themselves at the expense of minority shareholders. In another study, La Porta et al. (1999) documented that controlling shareholders have strong incentives to monitor managers and to maximise profits.

Eisenhardt (1989) has provided a table that summarises agency theory overview:

Table 3-1 Overview of Agency Theory

Key idea	Principal–agent relationship should reflect economically efficient organisation of information and risk-bearing costs
Unit of analysis	Contract between principal and agent
Human assumptions	Self-interest

	Bounded rationality Risk aversion
Organisational assumptions	Partial goal conflict among participants Economic efficiency as the effectiveness criterion Information asymmetry between principal and agent
Information assumption	Information as a purchasable commodity
Contracting problems	Agency (moral hazard and adverse selection) Risk sharing
Problem domain	Relationships in which the principal and agent have partly differing goals and risk preferences (e.g., compensation, regulation, leadership, impression management, whistle-blowing, vertical integration, transfer pricing)

Agency theory assumes that economic actors will behave so as to maximise their own utilities. Hence owners of a business will seek to maximise the value of the business (shareholder value). However, the interests of managers may not be the same as those of the owners, and hence the agent may not always work to serve the interests of the owners, or the agent may work only partly in the best interests of the owners, from which conflicts of interest may arise between the agent and the principals. For example, the agents may not use their power fully to manage corporations in the way that would be most likely to maximise shareholder value or may take on risks as they pursue interests that are attractive to them but that the owners or investors would prefer to avoid. Another problem is information asymmetry, whereby the investors and the agent have access to different sources of information, which can result in miscommunication and error (Mallin, 2007; Solomon, 2007). According to Byrd et al. (1998), the conflicts between agents and principals can be related to effort, horizon, differential risk preference, and asset use as defined in the table below:

Table 3-2 Types of Agency Problems

Agency Problems	Definitions
Effort	Managers may have incentives to exert less effort than stockholders expect them to.
Horizon	Managers tend to have shorter horizons for achieving investment results than stockholders have.
Differential risk preference	Managers typically have so much of their wealth tied to the on-going viability of the firm that they tend to be more risk-averse than stockholders.
Asset use	Managers can have incentives to misuse corporate assets or to consume excessive perks because they do not bear the full costs of such actions.

Source: Byrd et al. (1998).

According to Jensen and Meckling (1976), the principal can limit and reduce the divergence of interests with the agent by establishing appropriate incentives for the agent and by incurring monitoring costs that are designed to limit the aberrant activities of the agent. Jensen and Meckling (1976) agreed that establishing any type of agency relationship will incur three costs (as cited in Ishak, 2004):

1. Monitoring expenditures, which are incurred by the principal to give appropriate incentives to ensure that agents will act in the interests of the principal.
2. Bonding expenditures, which are incurred by the agent to guarantee the principal(s) that their interests are being pursued.
3. Residual costs, which are incurred when bonding and monitoring are unable to solve all agency conflicts.

Indeed, agency costs are higher in firms that are not 100 per cent owned by their managers, and these costs increase as the equity share of the owner-manager declines (Ang et al., 2000). Jensen and Meckling (1976, p. 312) stated that "agency costs will be generated by the divergence between his interests (they mean managers) and those of outside shareholders, since he will then bear only a fraction of the costs of any non-pecuniary benefits he takes out in maximizing his own utility".

Jensen and Meckling (1976) focused on how to reduce agency costs by maintaining separation between ownership (principals) and control (agents). On the other hand, they held that "it is generally impossible for the principal or the agent at zero cost to ensure that the agent will make optimal decisions from the principal's viewpoint" (p. 308). Agency costs arise when the interests of the managers are not aligned with those of the owners, which may lead to the formation of preferences for on-the-job perks, shirking, and working toward self-interested and entrenched aims that tend to reduce the owners' (shareholders') wealth (Ang et al., 2000).

Jensen and Meckling (1976) mentioned a further problem of agency: the conflict between debt holders and shareholders. Shleifer and Vishny (1997) documented that the agency problem in this situation refers to the difficulties debt holders have in assuring that their funds are not expropriated or wasted on unattractive projects. Denis (2001, p. 205) explained this conflict of interest between shareholders and debt holders as follows: "Management may choose to return cash to equity investors via dividends or repurchases, management is obligated to return specified amount of cash to debtholders at specified times or risk the loss of some or all of its control rights".

Existing empirical studies provide some evidence that financial and investment decisions as well as firm values and board of directors and ownership structures are affected by the presence of agency conflict (Florackis, 2008). For example, Bathala and Rao (1995, p. 59) claimed that "agency theory ascribes a significant role to the board of directors in the organizational and governance structure of the typical large corporation". Cadbury (2002) suggests that the agency problem is an important problem to be considered in corporate governance, given that it has its influence on the structure and composition of boards, on the disclosure requirements, and on the balance of power between shareholders and directors.

Furthermore, John and Senbet (1998) classified the agency perspective on corporate governance into two categories. They mentioned that the first perspective is *managerialism*, which refers to self-serving behaviours by managers. John and Senbet documented large corporations, particularly in the US, which were owned by a large number of shareholders and whose managers tended to lack major stock ownership positions, which led managers to push for the greatest interests even if doing so was illegal. The second perspective is *debt agency*, which refers to situations where the debt contract authorizes managers to work on behalf of owners (equity holders) to make sub-optimal investments and financial decisions by departing from the principle of value maximisation (John & Senbet, 1998).

Agency theory involves two patterns of development: the positivist theory of agency and principal–agent theory (Jensen, 1983). The two patterns are based on a common unit of analysis, in which the contract between the principals and the agent shares people, the organisation, and information; however, the two patterns differ in style, dependent variables, and mathematical rigour (Eisenhardt, 1989).

The first approach to agency theory is called the positivist agency theory. This theory subscribes to a broad idea of governance, in which the principals and the agent, when they are in conflict, set a goal and describe the governance mechanisms by which they will solve the agency problem (Eisenhardt, 1989). Positivist agency theory has focused particularly on cases of the principal–agent relationship between owners and managers of large public corporations (Berle & Means, 1932, as cited in Eisenhardt, 1989). The main role of theory in this approach is to provide testable hypotheses about practice in corporations. Within the assumptions set out above, it is assumed that agency contracts and structures are optimal in the sense that they represent the most economically efficient arrangements possible, given the constraints within which agents and principals are operating. Agency theory has a role in explaining why observed contracts and structures take the form observed in practice.

Most of the literature on agency theory focuses on the agent-principal relationships between managers and shareholders, where the principal–principal (dispersed - controlled) ownerships have little direct control over management (Ishak, 2004). The principal–principal conflict is one of the major agency problems in emerging economies (Young et al., 2008). Ownership concentration is common in most emerging markets (Wang and Shailer, 2009). According to agency theory, the presence of concentrated ownership provides an incentive to monitor and evaluate the performance of management (Shleifer and Vishny, 1986). La Porta et al. (1998) argued that concentrated ownership protected other shareholders' interests when the legal system provided only weak protection for minority shareholders. The principal– principal conflicts between controlling shareholders and minority shareholders are rooted in concentrated ownership, family ownership and control, business group structures, and weak legal protection of minority shareholders (Young et al., 2008). Young et al. (2008) explained the differences between traditional principal–agent conflicts and principal–principal conflicts.

Grossman and Hart (1980) mentioned another problem related to agency cost: the free rider problem. This is most commonly seen when individual shareholders who own a small number of shares and do not have the power to protect their interests appear to take a free ride and let others monitor the behaviour of the managers (Ishak, 2004). According to Al-Saidi (2010), the free ride problem arises when just one shareholder incurs all the costs and expenditures associated with reform but receives benefits and advantages in proportion to his or her ownership. This, in turn, gives managers the ability to pursue opportunistic behaviour and serve their own interests at shareholders' expense.

In Saudi Arabia, the agency costs of the listed companies may results from conflicts of interest between managers and owners (Alghamdi, 2012). Saudi Arabia is an emerging economy and is incurring another type of agency cost that arises from the conflicts of interest between minority ownership and concentrated ownership (Alghamdi, 2012).

Table 3-3 Principal-agent conflicts versus principal-principal conflicts

	Principal–agent conflicts as depicted in Anglo-American variety of agency theory	***Principal–principal conflicts that commonly occur in emerging economies***
Goal incongruence	Between fragmented, dispersed shareholders and professional managers.	Between controlling shareholders and minority shareholders.
Manifestations	Strategies that benefit entrenched managers at the expense of shareholders in general (e.g. shirking, pet projects, excessive compensation, and empire building).	Strategies that benefit controlling shareholders at the expense of minority shareholders (e.g. minority shareholder expropriation, nepotism, and cronyism).
Institutional protection of minority shareholders	Formal constraints (e.g. judicial reviews and courts) set an upper boundary on potential expropriation by majority shareholders. Informal norms generally adhere to shareholder wealth maximisation.	Formal institutional protection is often lacking, corrupt, or un-enforced. Informal norms typically favour the interests of controlling shareholders over minority shareholders.
Market for corporate control	Active as a governance mechanism 'of last resort'.	Inactive even in principle. Concentrated ownership thwarts notions of takeover.
Ownership pattern	Dispersed – holding 5–20% equity is considered 'concentrated ownership'. A shareholder with 5% equity stake is regarded as a 'blockholder'.	Concentrated – often more than 50% of equity is held by controlling shareholder. Often structured as a 'pyramid' where cash flow rights are greater than ownership rights
Boards of directors	Legitimate legal and social institutions with fiduciary duty to safeguard shareholders' interests. Research focuses on factors that affect day-to-day operations such as insiders vs. outsiders, background of directors,	In emerging economies, boards often have yet to establish institutional legitimacy and thus are ineffective. Research indicates they are often the 'rubber stamp' of controlling shareholders.

	committees.	
Top management team	Professional managers who have often made their way up through the ranks or are hired from outside after extensive search and scrutiny of qualifications. Monitored internally by boards of directors and externally by the managerial labour market.	Typically family members or associates. Monitored mainly through family consensus or self-regulation that adheres to ‘gentlemen’s agreements’.

Source: Young et al. (2008)

3.3 STEWARDSHIP THEORY

Stewardship theory is an alternative way to explain and describe the relationship between agents and principals (Dicke and Ott, 2002). It is contrary to agency theory in that, while agency theory is based on an economic model, stewardship theory is based in psychology and sociology literature (Albrecht et al., 2004). This theory concerns upper managers in corporations. The stewardship model is based on viewing one manager as a ‘steward’ rather than an agent with self-interested rationale (Muth and Donaldson, 1998). According to Davis et al. (1997, p. 24), in stewardship theory, ‘the model of the man is based on a steward whose behaviour is ordered such that pro-organizational, collectivistic behaviours have higher utility than individualistic, self-serving behaviors.” Stewardship theory envisions the creation of a board that readily facilitates and empowers rather than monitors and controls employees (Davis et al., 1997).

Different behaviours are implicit in the positions of agency theory and stewardship theory. Agency theory promotes self-serving behaviour; in contrast, stewardship theory involves pro-organisational behaviour (Davis et al., 1997). This means that the steward will work toward the interests of the organisation. Also, the steward seeks to attain higher value through co-operation rather than defection. In addition, when the interest of the steward and principal are not aligned, the steward will seek to make himself of higher value to the firm, because the steward will receive greater utility in co-operative behaviour (Davis et al., 1997).

The steward realizes the trade-off between personal needs and organisational objectives; when the steward works toward organisational objectives, personal needs will follow (Davis et al., 1997). Also, the benefits obtained from organisational behaviour are higher than the benefits from individualistic and self-serving behaviour because the pro-organisational behaviour raises the benefits for all stakeholder groups by increasing and improving firm performance (Donaldson and Davis, 1991; Davis et al., 1997).

Stewardship theory assumes a strong relationship between the organisation’s success and the satisfaction of principals (Davis et al., 1997). To satisfy the principals, the steward works to protect and maximise the principals’ wealth via firm performance, which indicates the organisation’s success (Alghamdi, 2012). Stewardship theory is thus based on strictly pro-organisational behaviour (Davis and Donaldson, 1994; Davis et al., 1997); this means that stewardship theory seeks to satisfy most groups (stakeholder groups). Most of the stakeholder groups have interests, and the pro-organisational steward is motivated to maximise the firm's performance, thereby satisfying the interests of all stakeholder groups (Davis et al., 1997).

Stewardship theory focuses on the structure of the board of directors (Donaldson and Davis, 1991). For example, CEOs, who are both the steward and chair of the board, possess more power, facilities, authority, and the empowering structure to determine strategy without fear from an outside chair of the board (Donaldson and Davis, 1991). The CEO-chair will enhance efficiency and productivity of the firm, and this leads to attaining performance returns on behalf the shareholders that are superior to those achieved in situations in which there is a separation of the roles of the chair and CEO (Donaldson and Davis, 1991; Davis et al., 1997).

Stewardship theory makes three assumptions with regard to the behaviour of managers (Ntim, 2009). It assumes that, when top managers spend their entire working lives in the company they govern, they better understand the business and have better knowledge than the outside directors (Donaldson and Davis, 1991, as cited in Ntim, 2009). The second assumption is that executive inside managers possess superior formal and informal information about the company they manage, through which they cause better decision making (Donaldson and Davis, 1994, as cited in Ntim, 2009). Finally, competitive internal and external market discipline and the fear of damaging their future managerial capital ensure that agency costs are minimised (Fama, 1980; Fama and Jensen, 1983, as cited in Ntim, 2009).

Table 3-4 Comparison between Agency theory and Stewardship theory

	Agency theory	**Stewardship theory**
Behaviour	Individual	Collective
Motivation	Extrinsic value	Intrinsic value
Governance	Monitoring	Trust
Time frame	Short term	Long term
Power	High	Low

Source: Alghamdi (2012).

3.4 STAKEHOLDER THEORY

Stakeholder theory is one of the essential theories that explain and describe corporate governance mechanisms, which are used widely as a corrective to perceived defects of business and business ethics. Stakeholder theory can also be used as an alternative model of corporate governance (Sternberg, 1997). The first use of the term ‘stakeholder theory’ was by Ansoff (1965) when he was defining the objectives of a firm (Alshehri, 2012). In agency theory, shareholders are the main concern. However, in the stakeholder theory, shareholders are but one of a number of important groups, such as customers, suppliers, and employees, which are affected by a firm’s success or failure (Heath and Norman, 2004). According to Mallin (2007, p. 16), “Stakeholder theory takes account of a wide group of constituents rather than focusing on shareholders”. By ‘constituents’, Mallin refers to the many different groups that have a relationship with the company; not just shareholders, but also, for example, employees, creditors, customers, suppliers, and government.

The term ‘stakeholder’ has become increasingly important in the management strategy and corporate governance field. It includes many kinds of people and groups that work together and have an impact on the firm (Sternberg, 1997). Stakeholders include a wide range of groups and individuals with interests that influence the company. For example, creditors are a group of stakeholders that includes banks or financial institutions. Creditors need to be confident about the safety of the money they have invested and also need to seek assurance from annual reports that the company is able to repay the money. The company’s objective is to get more money from creditors and to give creditors more confidence about their money; the creditors’ objective is to get debt repaid with interest (Mallin, 2007).

Stakeholder theory was first developed by R. Edward Freeman (1984), who developed the basic features of the concept of stakeholder theory in his book *Strategic Management: A Stakeholder Approach* (Solomon, 2007; Jones, 1995). Freeman (1984, p. 46, as cited in Mitchell et al., 1997, p. 856) stated: "A stakeholder in an organization is (by definition) any group or individual who can affect or is affected by achievement of the organization’s objectives". This is a wide definition of the term that includes not only stakeholders internal to a company but also any group that occupies the environment that surrounds a company. Each group gets benefits from the company and gives the company some benefits through a reciprocal relationship. For example, owners have some stocks or bonds in the company, and they expect to get a good financial return from the company, while employees get salaries and benefits such as job security and give the company their labour, services, and loyalty in return (Freeman, 1984; Donaldson and Preston, 1995).

Donaldson and Preston (1995) classified stakeholder theory into three stages: descriptive, normative, and instrumental. Donaldson and Preston (1995) suggest that this theory may be used to explain and describe some corporate characteristics and behaviour. Stakeholder theory can be described as the nature of the company (Brenner and Cochran, 1991, as cited in Donaldson and Preston, 1995) and as what managers actually do with respect to stakeholder relationships (Jones, 1995).

Donaldson and Preston (1995) normative theory can be used to interpret the corporate functions that include the moral and philosophical principles for firm management. Jawahar and McLaughlin (2001) highlighted that the normative stream of stakeholder theory concerns how managers should deal with corporate stakeholders. The normative stream focuses on all stakeholders' interests, not just those of shareholders (Jawahar and McLaughlin, 2001).

Instrumental theory is used to explain the connection between stakeholder management and the achievement of a firm's objectives and performance, such as growth and profitability (Donaldson and Preston, 1995). This offshoot of stakeholder theory is used to achieve the corporation's performance goals (Jones, 1995).

The key distinguishing features of the agency theory (shareholder perspective) and the stakeholder theory of corporate governance are summarised in table 3-5 below:

Table 3-5 Comparison between Agency theory and Stakeholder theory

	Agency theory	Stakeholder theory
Purpose	Maximise shareholder wealth	Multiply the objectives of parties with different interests
Governance structure	Principal–agent model (managers are agents of shareholders)	Team production model
Governance process	Controlling	Coordination, cooperation, and conflict resolution
Performance metrics	Shareholder value sufficient to maintain investor commitment	Fair distribution of value created to maintain commitment of multiple stakeholders
Residual risk holder	Shareholders	All stakeholders

Source: adapted from Kochan and Rubinstein (2000, as cited in Ayuso and Argandona, 2007).

3.5 TRANSACTION COST ECONOMICS THEORY

The transaction cost economics theory was founded by the work of Williamson (1975, 1984, as cited in Mallin, 2007), which builds on the earlier work of Coase (1937, as cited in Robins, 1987). The main reason for establishing this theory is increasing transaction costs and growing firm sizes (Dietrich, 1994). In addition, this theory seeks to explain the framework of a company in terms of the optimal selection between market and hierarchal provisions (Clark, 2004, as cited in Alghamdi, 2012). According to Robins (1987, p.69), transaction costs are “those costs associated with an economic exchange that vary independent of the competitive market price of the goods or services exchanged”. These costs include those incurred for searching, information seeking, and monitoring (Robins, 1987).

Transaction cost economics theory and agency theory are complementary, but today, given increases in firm size and complexity, transaction cost economics theory has become more useful (Solomon, 2007). Transaction cost economics theory is very closely related to agency theory: the latter considers the firm to be a nexus of contracts, but transaction cost economics theory views the firm as a particular form of governed organisation for transactions between one party and another (Mallin, 2007; Argyres and Liebeskind, 1999).

According to Mallin (2007, p.15), the nexus of contracts approach of agency theory assumes a “connected group or series of contracts amongst the various players, arising because it is seemingly impossible to have a contract that perfectly aligns the interests of principal and agent in a corporate control situation." Mallin implied that agency theory is concerned with making a distinction between ownership and control. However, transaction cost economics theory is concerned with when the firm grows in size through technological advances or evolving monopolies. This requires an increase in capital, which in turn leads to additional shareholders (Mallin, 2007).

Mallin (2007, p.15) stated that "there are certain economic benefits to the firm itself to undertake transactions internally rather than externally". This means that a larger and more complex firm requires more transactions; and, to become more efficient, the firm needs to develop structures that minimise transaction costs. For example, it should provide its own internal capital market, not an external market. Then, these transactions will be completed more cheaply within the firm than would using an external market (Mallin, 2007; Williamson, 1998). This provides a link between structure and firm performance: choosing an efficient structure (including a governance structure) should lead to enhanced firm performance.

Solomon (2007) suggested that a firm's management should 'internalize transactions as much as possible'. Solomon explained that the main reason for internalization is removing risk and uncertainty about the future prices of products. This reduction of risks, such as information asymmetry, becomes an advantage to the firm, and hence should lead to enhanced performance.

3.6 RESOURCE DEPENDENCE THEORY

There is another theory used in corporate governance research that has also become one of the most important theories in organisational and strategic management (Hillman et al., 2009). According to Johnson (1995, p.1) stated that "resource dependence theory is a theory of organization(s) that seeks to explain organizational and inter-organizational behaviour in terms of those critical resources which an organization must have in order to survive and function". Resources dependence theory was founded with the publication of Pfeffer and Salancik (1978)'s *The external control of organizations: A resource dependence perspective* (as cited in Hillman et al., 2009). The central idea of this theory is that firms attempt to exert control over their environment by co-opting the resources needed to survive (Muth and Donaldson, 1998; Jawahar and McLaughlin, 2001).

The main objective of this theory is to maximise organisational autonomy; organisational leaders use a variety of strategies to manage external constraints and dependencies (Johnson, 1995). According to Davis and Cobb (2009), resource dependence theory has three primary ideas: social context matters, organisations have strategies to enhance their autonomy and pursue interests, and organisations have the power to understand their internal and external actions.

Resource dependence theory describes the mechanisms of corporate governance mechanisms and how they can affect firm performance (Hillman et al., 2009). Pfeffer and Salancik (1987, p. 163, as cited in Hillman and Dalziel, 2003) noted "when an organization appoints an individual to a board, it expects the individual will come to support the organization, will concern himself with its problems, will variably present it to others, and will try to aid it". According to Hillman and Dalziel (2003), boards can provide four primary benefits: advice and counsel; legitimacy; channels for communicating information between external organisations and the firm; and preferential access to commitments or support from important elements outside the firm.

3.7 SUMMARY

This chapter discussed the relevance of various theories that explain the field of corporate governance. The theoretical framework chapter enables the reader to build a full picture of the theories that relate to and affect corporate governance studies. These theories interpret with more explanation the relationship between corporate governance and firm performance, which makes the results more logical and rational. Agency theory is the theory most often used to explain the relationship between corporate governance and firm performance. It is a fundamental theory used to develop and improve corporate governance principles, codes, and standards (Habbash, 2010). But other theories (such as stewardship theory or resource dependence theory) explain some results of the relationship between corporate governance variables and firm performance.

In Saudi Arabia, the listed companies are characterised by governing ownership, different types of blockholder ownership (e.g., corporation, banking, and insurance companies), family ownership, and some small foreign ownership (Albarrak, 2011; Alghamdi, 2012). Concentrated ownership leads to a closer alignment of interests and goals, which could affect firm performance (Tam and Tan, 2007). This could mitigate the agency problem and reduce agency cost (Alghamdi, 2012). Stewardship theory, resource dependence theory, stakeholder theory, and transaction cost economic theory are all alternative theories to support some of this study’s findings. The table below 3-6 summarises the main points of the aspects of each theory. The next chapter will review a literature that concern on the relationship between corporate governance and firm performance from various theories.

Table 3-6 Comparison between Agency, Stewardship, Stakeholder, Transaction cost economics, and Resource dependence theories

Aspect	***Agency theory***	***Stewardship theory***	***Stakeholder theory***	***Transaction cost economics theory***	***Resource dependence theory***
Founded by	Based on the ideas of Adam Smith (1776) and Berle and Means (1932), whose work provided an explanation of the separation between ownership and control. Modern formulation by Jensen and Meckling (1976).	The work of Donaldson and Davis (1989–1991)	R. Edward Freeman (1984)	Based on the ideas of Ronald Coase (1937). Formulated as a distinct theory by Oliver Williamson.	Resource dependence theory was founded by the publication of Pfeffer and Salancik's (1978) *The external control of organizations: A resource dependence perspective* (cited in Hillman et al., 2009).

Definition	Jensen and Meckling (1976) defined an agency contract as a contract under which one or more person (the principals) engage another person (the agent) to perform some service on their behalf that involves delegating some decision making.	Davis et al. (1997) defined stewardship theory as an organisation in which the model of the manager is based on a steward whose behaviour is ordered such that pro-organisational, collective behaviours have higher utility than individualistic and self-serving behaviours.	Freeman (1984) defined a stakeholder in an organisation as any group or individual who can affect or is affected by the achievement of the organisation's objectives. Mallin (2007) defined stakeholder theory as taking account of a wide group of constituents rather than focusing on shareholders.	Robin (1987) defined transaction cost as the costs associated with an economic exchange that are independent of the competitive market price of the goods or services exchanged.	The central idea of this theory is that firms attempt to exert control over their environment by co-opting the resources needed to survive (Muth and Donaldson, 1998; Jawahar and McLaughlin, 2001).
The main problem	- Agency problems occur	Stewardship theory seeks to increase	- To which shareholders	According to Coase (1937), the main	According to Johnson (1995, p. 1) "Resource

	when cooperative parties have different goals (conflict of interests). - Risk sharing	cooperative behaviour and explores how organisational objectives can be met along with personal needs.	managers should be accountable and how accountability is achieved. - How managers can satisfy the different interests of all stakeholders.	problem of this theory is that, as a firm becomes larger and more complex, there may be decreasing returns to the entrepreneur function; that is, the cost of organising additional transactions within the firm may rise.	dependence argument suggests that a given organization will respond to and become dependent on those organizations or entities in its environment that control resources which are both critical to its operations and over which it has limited control".
The main objective	Maximising value for the principals (for companies, the principals are the shareholders)	The objectives of the organisation – this may involve increasing firm performance or some other objective.	The main objective of this theory is to produce benefits to all stakeholder groups (corporate social responsibilities).	Minimising transaction costs, which leads to enhancing firm performance.	Maximising organisational autonomy.

Unit of analysis	Individual contract between agent and principal	Contract between steward and principal	Corporate social responsibilities	Transaction cost	Dependence resource
Strategic intent	Shareholders' view	Organisational view	Stakeholders' (environment's) view	Shareholders' view	Organisation's view
Behaviour	Individualistic and self-serving behaviours	Pro-organisational behaviour	Social behaviour	Individualistic behaviour moderated somewhat by organisational behaviour	Organisational behaviour
Focus	Monitor and control	Facilitate and empower	Corporate social responsibilities	Internalise transaction cost	Resources

4 LITERATURE REVIEW

4.1 INTRODUCTION

This chapter reviews the literature that focuses on the relationship between corporate governance and firm performance. The internal corporate governance mechanisms play an important role affect the firm performance. The literature review chapter highlights previous studies about the board of directors’ structure and ownership structure. This chapter provides an overview of the existing literature on the board of directors’ structure, with concerns on board size, family board members, royal family board member, outside non-executive directors and board committees. Also, this chapter investigates the relationship between ownership structure and firm performance through the use of several mechanisms; insider (managerial) ownership, family or individual ownership, institutional government ownership, foreign investors, financial and non-financial firm ownership. In addition, this chapter sets the research hypotheses after each variables dependes on the literature.

4.2 BOARDS OF DIRECTORS STRUCTURE

The board of directors is a very important element in the internal corporate governance mechanism. The board of directors of a company performs the critical functions of monitoring and advising top management (Coles et al., 2008). The separation of ownership and control in most corporations creates potential conflicts between managers and shareholders; these conflicts can be mitigated by the board of directors (McWilliams and Sen, 1997). Mallin (2007) highlighted that organizations with effective boards are able to lead and control their companies so that they are successful. Solomon (2007, p. 77) stated that "A company's board is its heart and as a heart it needs to be healthy, fit and carefully nurtured for the company to effectively".

4.2.1 ROLES, DUTIES, AND RESPONSIBILITIES OF THE BOARD OF DIRECTORS

Sir Adrian Cadbury (1992) indicated that the main responsibilities of a board of directors include setting the company’s strategic aims, providing leadership, supervising managers, and reporting to shareholders on their stewardship. Cadbury (2002) also outlined the main functions of a board:

1- To define the company’s purpose.
2- To agree on strategies, plans, and policies toward achieving that purpose.

3- To appoint a chief executive.
4- To monitor and assess the performance of the executive team.

The UK combined code (2006, p.3) stated the following:

> "The board's role is to provide entrepreneurial leadership of the company within a framework of prudent and effective controls which enables risk to be assessed and managed. The board should set the company's strategic aims, ensure that the necessary financial and human resources are in place for the company to meet its objectives and review management performance. The board should set the company's values and standards and ensure that its obligations to its shareholders and others are understood and met."

Epstein and Roy (2006) (cited in Mallin, 2007) stated that a high-performance board must achieve three core objectives:

1- Provide strategic guidance to ensure the company's growth.
2- Ensure accountability for the company and help to bring about prosperity.
3- Ensure that a highly qualified executive team is managing the company.

4.2.2 UNITARY AND DUAL BOARDS OF DIRECTORS

There are two different approaches with regard to boards of directors: the unitary board (one tier) and the dual board (two tiers). Unitary boards are found in countries that have been influenced by the Anglo-Saxon model of corporate governance and in common law countries (e,g., UK, USA, Canada, Australia, New Zealand) (Solomon, 2007; Mallin, 2007; Falgi, 2009). A unitary board is characterized by one single board encompassing both executive and non-executive directors (Mallin, 2007). A unitary board is also responsible for all aspects of a company's activities, and the directors are elected by the shareholders (Mallin, 2007).

Dual boards or two-tier boards have two separate boards, a supervisory board and a management board (Solomon, 2007). The two-tier model is used throughout Europe; it was developed in Germany (Cadbury, 2002). It deals with civil-law countries, such as Germany, France, Austria, and Netherlands (Solomon, 2007; Falgi, 2009). In this approach, there is a clear separation between the functions of supervision and management (Mallin, 2007). The supervisory board deals with strategic decisions (Solomon, 2007). In addition, the supervisory board oversees the direction of the business (Cadbury, 2002; Mallin, 2007). The chairman of the company sits on the supervisory board as a non-executive (Solomon, 2007). The management board includes only executives and is headed by the chief executive, who deals with operational issues (Solomon, 2007). The management board is responsible for the running of the company (Cadbury, 2002). Table below summarises the key differences between supervisory and management boards in the dual-boards approach.

Table 4-1 The differences between supervisory and management boards in the dual-board approach

Supervisory board	Management Board
Members (shareholder representatives) are elected by the shareholders in a general meeting, or members (employee representatives) nominated by the employees	Members appointed by the supervisory board
Controls the direction of the business	Manages the business
Oversees the provision of information and that an appropriate system has been put in place by the management board	Provides various financial information and reports and the installation of an appropriate system, e.g., a risk management system

Source: Mallin (2007)

4.2.3 BOARD SIZE

Board size is a very important variable in determining firm performance. The main question in this part is: What is the ideal size for the board of directors? To maximize firm performance, Raheja (2005) documented that boards of directors should feature three types of members: the chief executive officer (CEO), the inside directors who are senior managers of the firm, and the outside directors. Two theoretical frameworks describe the relationship between board size and firm performance: agency theory and resource dependence theory. For these two theories, the relationship between board size and firm performance has produced mixed results (Hillman & Dalziel, 2003; Jensen, 1993; Lipton and Lorsch, 1992; Yermack, 1996). According to Pearce and Zahra (1992), three important reasons exist regarding why empirical research on the determinants of boards of directors is essential: first, due to the importance of board composition variables in the undertaking of director roles and in subsequent contribution to company performance, their predictors need to be understood. Second, because significant variations exist in the size and type of directors on boards, even when companies function in the same industry, the causes and possible justification of these variations need to be delineated. Third, predictors of board composition variables are believed to reflect the critical demands of success in an industry and firm's strategy.

Lipton and Lorsch (1992) preferred boards of eight members or nine members, with at least two independent directors. According to Jensen (1993), the optimal size of a board of directors is seven members or eight members, and when a board is larger than this number, it is less likely to function effectively and becomes harder for the CEO to control. Furthermore, Firstenberg and Malkiel (1994) suggested that the size of a board of directors should be no larger than eight members, given that small boards engender greater focus, participation, and genuine interaction and debate.

Lipton and Lorsch (1992) supported the agency theory perspective, arguing that small boards allow directors to get to know one another and are conducive to more effective discussion among all directors. Hermalin and Weisbach (2003, p. 13) stated, that " The idea is that when boards get to be too big, agency problem (such as director free-riding) increase within the board and the board becomes more symbolic and less a part of the management process". In addition, Beiner et al. (2004, p. 328) supported the view of Hermalin and Weisbach (2001), stating that “when boards become too big, agency problem (e.g., director free-riding) increase and the board becomes more symbolic and neglects its monitoring and control duties”.

Moreover, Jensen (1993) said that a small board of directors can help to improve firm performance, and he suggested that a board size of seven members or eight members is easier for the CEO to control and makes communicating with other members easier as well. Yawson (2006) supported the agency theory; he argued that larger boards suffer higher agency problems and are far less effective than are smaller boards. In addition, larger boards have increased problems with communication and coordination, which lead to the decreased ability to control management (Cheng, 2008; Eisenberg et al., 1998).

Contrary to the agency theory view is resource dependence theory. According to Hillman and Dalziel (2003), resource dependence theory prefers the larger board because it enables the firm to more easily form capital environment linkages and resources (Abdullah, 2007). Zahra and Pearce (1989) said that a larger board is assumed to have more directors with various educational and industrial backgrounds and skills, which improves the quality of action and increases firm performance. In addition, according to Goodstein et al. (1994), Pearce and Zahra (1992), and Pfeffer (1987) (as cited in Haniffa and Hudaib, 2006), a larger board of directors helps companies to secure critical resources and reduced environmental uncertainties. Furthermore, Coles et al. (2008) documented that large boards are correlated with providing more advice to companies, which leads to a greater ability to solve problems. Large boards lead to more difficulties as companies attempt to arrange appropriate board meetings, and they also are less efficient and slower at decision-making (Cheng, 2008). According to Kiel and Nicholson (2003), resource dependence theory argues that a large board size provides firms with greater opportunities to form links and hence increases access to resources.

Zahra and Pearce (1989, p. 309) stated that "larger boards are not as susceptible to managerial domination as their smaller counterpart. They are also more likely to be heterogeneous in member background, values, and skills. Thus, they are likely to resist managerial domination and present shareholders interest. Therefore, those boards will be more actively involved in monitoring and evaluating CEO and company performance, normally through specialized committees". Bathula (2008) said that a larger board provides some benefits to firms, such as the effective oversight of management, making necessary resources available, and allowing for the representation of different stakeholders in the firm, which lead to enhanced firm performance.

Empirical studies that examined the relationship between board size and firm performance produced mixed results. In the developed market, Eisenhardt and Schoonhoven (1990) conducted one of the earliest studies concerning the relationship between board size and firm performance. They studied the relationship between board size and firm performance among United States (U.S.) firms from 1978 to 1985, using firm growth as a dependent variable. They found that a large team had more skills and experience, which led to increased firm growth, thus supporting the resource dependence theory. However, Yermack (1996), using the same sample that Eisenhardt and Schoonhoven (1990) used, studied the relationship between board size and Tobin’s Q of 452 large U.S. industrial firms between 1984 and 1991 and found a negative relationship between board size and performance.

In addition, Cheng (2008) studied the relationship between firm performance and board size in the US for the sample of 1,252 firms covered by the Investor Responsibility Research

Centre (IRRC) for the period of 1996–2004. The results indicated that board size is negatively associated with firm performance, and Cheng's study indicated that larger boards have lower variability of corporate performance. Lee and Filbeck (2006) studied the relationship between board size and firm performance among small firms in the US, of which total assets were less than $18 million (1,013 firms). They found a negative relationship between board size and firm profitability, which Yermack (1996) also found when using a sample of large U.S. firms.

In addition, the new study of the relationship between board size and firm performance in the U.S. by Gill and Obradovich (2012). They examined this relationship among a sample of 333 firms listed on New York Stock Exchange (NYSE) for a period of 3 years from 2009-2011. They found that the larger board size negatively impacts the value of Americans firms, this study also, indicated that the board size positively related with firm size.

Conyon and Peck (1998) studied the relationship between board size and financial performance among five European countries (United Kingdom, France, Netherland, Denmark and Italy). They collected data from DataStream International and used two measures of corporate performance (ROA and Tobin's Q) during 1992–1995 with regard to observable measures of board size. They found a negative relationship between board size and firm performance. In another developed country, Canada, Bozec (2005) studied the relationship between board size and firm performance for the long period of 1976 to 2000 and found a negative relationship between board size and return on sales.

Guest (2009) supported the findings of Conyon and Peck (1998). He examined the impact of board size on firm performance using a large sample of 2,746 United Kingdom (UK)-listed firms for the period of 1981–2002. He found that board size has a strong negative impact on profitability (ROA), Tobin's Q and share return. The researcher used three econometric techniques to examine this relationship. He used the OLS technique and found a significant negative relationship. Meanwhile, the fixed effects technique found a negative significance at a level of 1%. Finally, the researcher used GMM for dealing with the endogeneity problems and found a significant negative relationship. Both of these two studies (Conyon and Peck, 1998; Guest, 2009) supported the argument that problems of poor communication and decision-making undermine the effectiveness of large boards.

In Switzerland, Loderer and Peyer (2002) found that a large board size was associated with lower firm value (Tobin's Q) in the Swiss stock exchange from 1980–1995. They found that the average number of board members decreased from 10.5 in 1980 to 8.5 in 1995. They also suggested that a large board size identifies firms that are not run as effectively as other firms are, and they finally reached the conclusion that "larger boards are comparatively ineffective" (p. 190). On the other hand, Beiner et al. (2004) did not find a significant relationship between board size and firm valuation in Switzerland in 2001. However, in another study by Beiner (2006), using the same data in Switzerland in 2002, the author found that board size is positively related to Tobin's Q but that neither the presence of controlling shareholders nor large (outside) block shareholders have a significant impact on valuation.

Among various developed countries, De Andres et al. (2005) studied the relationship between board size and performance among the larger non-financial companies from 10 countries: Belgium, Canada, France, Germany, Holland, Italy, Spain, Switzerland, the UK and the US. They found a negative relationship between board size and firm performance (Tobin's Q). In addition, they mentioned that this negative effect persists after controlling for an alternative definition of firm size, board composition and internal function, country effect, industry effect, and measure of performance (except for ROA). In addition, Eisenberg et al. (1998) studied 785 healthy firms and 97 bankrupt firms in Finland. That study found a negative relationship between board size and ROA.

In Japan, Sakawa and Watanabel (2007) studied the relationship between board size and firm performance, and they found a negative relationship between board size and firms' performance. Toledo (2010) found that larger boards have a negative impact on firm value in Spain. His results indicated that the breakpoint for a board's size is seven members; when a board becomes larger than this point, firm value is negatively affected.

A number of previous studies focused on the relationship between board size and firm performance in the emerging market and found mixed results. Mak and Kusnadi (2005) studied the relationship between board size and Tobin's Q in two samples: The first sample comprised 271 firms listed on the Singapore stock exchange, and the second sample consisted of 279 firms listed on the Kuala Lumpur stock exchange from 1999 to 2000. They found an inverse relationship between board size and Tobin's Q in both countries. Haniffa and Hudaib (2006) examined the relationship between board size and firm performance according to two measures (Tobin's Q and ROA) in Malaysian firms from 1996 to 2000. The researchers found that when they used Tobin’s Q, a large board was less effective at monitoring performance; also, they found a positive relationship between board size and performance based on ROA. In addition, they suggested that large boards with experience and expertise are needed to enhance firm performance.

Sanda et al. (2005) found a positive relationship between board size and firm performance in a sample of 93 Nigerian listed firms from the period of 1996 to 1999. In addition, Sulong and Nor (2010) found a positive relationship between board size and Tobin's Q among 403 firms listed on the Bursa Malaysia over a four-year period from 2002 to 2005. They argued that firms with smaller boards seem to be associated with less efficient use of assets and lower firm valuation. Mangena and Tauringana (2008) found that a larger board size enhances firm performance in an environment of economic and political uncertainty in Zimbabwean listed companies. All of these studies support Haniffa and Hudaib’s (2006) notion that large boards with experience and expertise are needed to enhance firm performance.

A recent study, by Yasser and Al Mamun (2012) studied the relationship between board structures and firm performance for five years data of listed companies in Pakistan. They used various firm performance measures such as ROA and Tobin's Q. The results indicated that the board size positive related with firm performance. This results supported the results of the previous studies in the Emerging markets (Sanda et al., 2005; Sulong and Nor, 2010; Haniffa and Hudaib, 2006; Mangena and Tauringana, 2008).

Moreover, a few bodies of literature examine the relationship between board size and firm performance in the Middle East and North Africa (MENA) region. Aljifri and Moustafa (2007) studied that relationship between board size and firm performance among a sample of 51 firms for the 2004 period for the firms listed in the United Arab Emirates (UAE). They used Tobin's Q to measure firm performance, and they found an insignificant relationship between board size and firm performance in the UAE. They indicated that this results in an insignificant relationship beyond the absence of a real application of the appropriate corporate governance regulations in the UAE. Also, Al-Saidi (2010) studied the relationship between board size and firm performance in the Kuwait and found a insignificant relationship between board size and firm performance.

In conclusion, the majority of the studies in the developed market found a negative relationship between board size and firm performance, which the agency theory view supports. Yermack (1996), Cheng (2008), Lee and Filbeck (2006), Conyon and Peck (1998) and Sakawa and Watanabel (2007) believe that a smaller board has a positive effect on firm performance: Smaller boards are more effective, are easier to control and allow for easier communication, which ultimately lead to better performance.

On the other hand, a number of studies in the emerging market support a larger board. The studies of Haniffa and Hudaib (2006), Sanda et al. (2005), Sulong and Nor (2010), and Mangena and Tauringana (2008) are from emerging markets and support resource dependence theory. This means that these emerging markets need more directors who have various educational and industrial backgrounds and skills along with greater opportunities to form more links and thus have better access to resources (Kiel & Nicholson, 2003; Zahra & Pearce, 1989).

For Saudi listed companies, the corporate governance regulations in the Kingdom of Saudi Arabia specify that the board size shall not be less than three and no more than eleven. Empirical studies in most of the emerging markets, the group to which Saudi Arabia belongs, suggest the following hypothesis for the relationship between board size and a firm's performance:

$H_{1:}$ A positive relationship exists between board size and firm performance.

4.2.4 NON-EXECUTIVE MEMBERS

Non-executive directors are vital to guaranteeing the integrity and accountability of firms, and bring valuable external experience that can contribute to those firms' strategic success (Clarke, 1998). Chen and Jaggi (2000) noted the important role of non-executive directors in ensuring the accuracy of information that managers provided. Pye (2001) defined the role of non-executives as preventing the undue exercise of power by the executive, safeguarding shareholders' interests in the board's decision making, and contributing to strategic decision making to ensure competitive performance. Mallin (2007) explained the two dimensions of a non-executive director's role. The first dimension is to help ensure that an individual or group cannot unduly influence the board's decision; the second is to direct the overall leadership and development of the company. Roberts et al. (2005) stated that the role of the non-executive director is indeed vital to enhancing the effectiveness of the board. He or she serves as a source of confidence for distant investors. The non-executive director also supports executives in their leadership, monitors and controls executive conduct, removes non-performing CEOs, and provides additional expertise and knowledge to the firm (Weisbach, 1988; Tricker, 1984; Stewart, 1991; Rechner & Dalton, 1991; Dahya et al., 1996; Higgs, 2003; Roberts et al., 2005; Haniffa & Hudaib, 2006). Agrawal and Knoeber (2001) suggest bringing in outside experts as members of the board of directors to solve business problems when insiders are not familiar with such issues.

The presence of independent non-executive directors on a company board helps to reduce the notorious conflict of interest between shareholders and management (Solomon, 2007). According to Vafeas and Theodorou (1998, p. 386), “Director independence is compromised for non-executive directors having a fiduciary relationship with the firm, such as management consultants, executives in financial institutions, and the firm’s legal counsel (collectively called ‘grey’ directors), and for interlocking directors.”

A number of codes and regulations regulate the work of non-executive members. For example, Higgs (2003, p.36) stated, “The majority of non-executive directors should be independent of management and free from any business or other relationship which could materially interfere with the exercise of their independent judgment, leaving it to boards to identify which of its non-executive directors are considered to meet this test.” In addition, the UK combined code (2006, p. 3) states, “Non-executive directors should scrutinize the performance of management in meeting agreed goals and objectives and monitor the reporting of performance. They should satisfy themselves on the integrity of financial information and that financial controls and system of risk management are robust and defensible. They are responsible for determining appropriate levels of remuneration of executive directors and have a prime role in appointment, and where necessary removing, executive directors, and in succession planning.”

A number of theories describe the relationship between non-executive members and firm performance. The first of these is agency theory, as described by Mizruchi (1988) (as cited in Dalton et al., 1998, p.270), “Agency theory is a control-based theory in that managers, by virtue of their firm-specific knowledge and managerial expertise, are believed to gain an advantage over firm owners who are largely removed from the operational aspects of the firm.” Agency theory has had an important effect on governance reform in boards of directors. According to this theory, an effective board should be comprised of outside directors who provide superior performance benefits to the firm as a result of their independence from the managers (Dalton et al., 1998). Agency theory also discusses the dangers of too close a relationship between executive and non-executive directors and the collusion that this might imply. The theory suggests splitting the roles of chairperson and chief executive, with the chairperson being an independent non-executive (Roberts et al., 2005).

Stewardship theory, on the other hand, suggests that insider-dominated boards (executives) are favoured for their depth of knowledge, good access to operating information, technical expertise and commitment to the firm (Muth and Donaldson, 1998). This theory argues that executive members, such as the CEO and other executives, are responsible for the day-to-day management of the company, and have the specialised expertise and wealth knowledge to manage the business (Weir and Laing, 2001). Stewardship theory predicts that shareholders can expect to maximise their returns when the organization structure facilitates effective control by management (Muth and Donaldson, 1998). Weir and Laing (2000) documented that non-executive members may have difficulty understanding the complexities of the company, which means they have less knowledge about business activities, particularly since outside directors are usually part-time and may sit on a number of other boards.

The resource dependence theory suggests that putting more resource-rich outsider directors on the board brings in needed resources, which leads to better performance (Peng, 2004). In addition, the board of directors takes on a broader, more inclusive role, with non-executive directors involved in giving advice and enhancing strategy discussions (Roberts et al., 2005), and providing services to the firm such as consulting, supplying loans, and interlocking directors (Clifford and Evans, 1997).

Empirical studies on the relationship between board composition and firm performance have produced mixed results depending on the nature of the theoretical framework explaining the relationship between firm performance and non-executive members. A number of studies examine the relationship between non-executive members and firm performance in developed markets. For example, Baysinger and Butler (1985) examined this relationship in terms of the issues raised by corporate governance, studying 266 major U.S. corporations between 1970 and 1980. The researchers used relative financial performance (RFP), which is calculated by dividing a firm's return on equity by the average return on equity for all the firms in its primary industry, and found a positive relationship between change in number of non-executive directors and improvement in firm performance. They suggested that reforming corporate governance mechanisms to include the correct proportion of independent outside directors on the board of directors would potentially improve performance.

Beasley (1996) studied the proportion of outsiders on the boards of directors of 150 firms from 1980-1991. Seventy-five of the 150 firms represented fraud firms. The researcher used two sources to identify the fraud firms: Accounting and Auditing Enforcement Releases (AAERs) and the Wall Street Journal Index (WSJ Index). Through logistic cross-sectional regression, he found that the boards of directors of fraud firms had significantly fewer outside members and more management directors than no-fraud firms. He also found that fraud firms had a smaller proportion of independent directors than no-fraud firms did. Overall, a larger proportion of outside members on a board of directors reduced the likelihood of financial statement fraud.

Schellenger et al. (1989) examined the relationship between board composition and firm performance among 526 firms in the U.S. Using various measures of firm performance, they found a positive relationship between outsider directors and ROA, but no relationship with ROE. Hermalin and Weisbach (1991) studied the relationship between board composition and firm performance among 142 U.S. firms (NYSE). They applied piece-wise linear equations using board composition. They found essentially no effect of board composition on Tobin's Q; they also treated the endogeneity problem and still found no relationship between outsider directors and firm performance.

Brown and Caylor (2004) studied the relationship between corporate governance and firm performance in 2,327 firms based on 51 corporate governance provisions provided by the Institutional Investor Service (ISS) in 2003. The researchers used three categories to measure firm performance: operating performance (return on equity, profit margin, and sales growth), valuation (Tobin’s Q), and shareholder payout (dividend yield and share repurchases). The researchers also used Gov-Score to measure boards of directors with regard to 51 factors of corporate governance. These factors cover eight governance structures: audit, board of directors, charter/bylaws, director education, executive and director compensation, ownership, progressive practices, and state of incorporation. The study found a strong positive significant relationship between independent outside directors and firm performance based on return on equity, net profit margin, dividend yield, and share repurchases, and found a negative significant relationship with Tobin’s Q and sales growth.

Mura (2007) investigated the relationship between firm performance and board composition among the UK firms for the period 1991-2001. The study used the GMM model to control the endogeneity and unobserved heterogeneity. Mura's study found a positive relationship between non-executive board members and firm performance. In addition, Dahya and McConnell (2003) indicated that increasing the number of outside directors on the board is likely to influence board decisions positively and enhance firm performance in the UK firms.

In another study in the United Kingdom, Abdullah (2007) studied the relationship between corporate governance mechanisms and firm performance among FTSE 350 non-financial companies in the UK. The study used various firm performance measures for the period 1999 to 2004. For the period of 1999 to 2001, there is a positive relationship between Tobin's Q and board independence. However, for the period 2002 to 2004, Abdullah found a negative relationship between board independence and Tobin's Q. The study also applied 2SLS to control the endogeneity, and got the same OLS results.

On the other hand, Agrawal and Knoeber (1996) examined the effect of outside directors on firm performance by studying 400 large US corporations and using Tobin's Q to measure firm performance. The researchers used two econometric estimators to examine this relation (OLS/2SLS) and found that outsiders had a negative effect on firm performance. In addition, Bhagat and Black (2000) investigated the relationship between board independence and firm performance in the US. They found a negative relationship between firm performance and board independence for both OLS and 3SLS. Beiner et al. (2004) also identified a negative relationship between firm performance and external directors in Swiss-listed firms.

In the emerging markets, a number of studies have examined the relationship between non-executive members and firm performance. Luan and Tang (2007) studied the relationship between outside directors and firm performance in Taiwan. They used ROE to measure firm performance in Taiwan's electronics industry and ordinary least squares to test their hypotheses. The researchers found that the appointment of independent outside directors to a board was positively and significantly related to firm performance. Choi et al. (2007) also found a positive effect of independence directors on firm performance in Korea.

On the other hand, Haniffa and Hudaib (2006) studied the relationship between non-executive directors and firm performance in 347 companies listed on the Kuala Lumpur Stock Exchange from 1996–2000. The study used ROA and Tobin's Q to measure firm performance. The researchers did not find a significant relationship between non-executive directors and firm performance. Yasser and Al Mamun (2012) studied the relationship between board structures and firm performance for five years data of listed companies in Pakistan. They used various firm performance measures such as ROA and Tobin's Q. The results indicated that there is no significant relationship between non-executive members with firm performance. However, Amran and Ahmad (2010) studied the relationship between corporate governance mechanisms and firm performance among 730 companies listed on Bursa Malaysia from 2003 to 2007. They found a negative relationship between firm performance and board independence. In addition, Kumar and Singh (2012) found a negative relationship between outside directors and firm performance in India.

Moreover, there is a small body of literature examining the relationship between non-executive members and firm performance in the MENA region. For example, Abu-Tapanjeh (2006) studied the relationship between corporate governance mechanisms and firm performance based on 39 industrial companies listed in the Amman Stock Exchange in Jordan for the period of 1992–2004. The study found that non-executive board members improved firm performance, which means that outsider directors have good communication with the environment and provide useful information to help manage the firms well. El Mehdi (2007) found similar results showing that the presence of outside directors is positively related to firm performance in Tunisian listed companies. El Mehdi suggested that this positive effect on firm performance occurs because non-executive members are motivated to take their responsibilities seriously in order to enhance their reputations. In addition, the fraction of non-executives on the board is not high, which give them more concentrated decision. Al-Saidi (2010) also identified a positive relationship between non-executive members and firm performance in Kuwait.

Despite the fact that previous studies have presented mixed results regarding the relationship between non-executive members and firm performance in both developed and emerging countries, the majority of researchers have argued that the presence of non-executive members contributes to the reduction in the conflict of interests between shareholders and managers. The regulations of corporate governance in Saudi Arabia suggest that the majority of the board members should be non-executive in order to make positive contributions to the development and performance of the business because they may have a broader view of different experiences and fields of knowledge that may affect firm performance (Cadbury, 1992). The literature therefore suggests the following hypothesis for the relationship between non-executive members and firm performance:

H_2: A positive relationship exists between non-executive members and firm performance.

4.2.5 FAMILY BOARD MEMBERS

Family control, or the presences of family board members, is a very widespread practice in most countries of the world, particularly in developing countries (Yeh et al., 2001). The agency theory proposes that family owner-management enhances communication and cooperation within a firm and guards against opportunism, which leads to increased firm performance and reduced agency costs (Schulze et al., 2003). The agency theory suggested that the existence of family board members on the board of directors leads to reduce and eliminate the agency problem between management and shareholders when the company is controlled by the same family (Al-Saidi, 2010).

Fama and Jensen (1983) claim that family-controlled firms enjoy more advantages in monitoring and disciplining related to decision agents, which leads to reduced monitoring costs. In addition, McConaugby et al. (2001) found that firms controlled by family members are generally run more efficiently than other firms, carry less debt than other firms, and gain greater value as measured by the market equity/book equity ratio. On the other hand, the resource dependence theory suggested that directors with family connections or other social relationships with the CEO/management may also be more motivated to provide resources (Hillman and Dalziel, 2003).

There is a number of publicly-traded companies around the world that are controlled by founders or their families (Piesse et al., 2012). In the developed market, the literature reveals mixed results of the relationship between family board members and firm performance. For example, in Canada, Smith and Amoako-Adu (1999) examined the financial performance of 124 management successions within Canadian family-controlled firms between 1962 and 1996. This study found that poor corporate performance led to the selection of non-family insiders or outsiders to improve firm performance. This means that there is a negative relationship between family management and firm performance, assuming that the young age of family-based managers reflects a lack of management experience.

In contrast to Smith and Amoako-Adu (1999), Ben-Amar and Andre (2006), investigated the relationship between ownership structure and firm performance among a sample of 327 Canadian firms for the period 1998–2002. This study investigated the role of family ownership and family management (CEO is a family member); they found that having a family member as the CEO has a positive impact on firm performance.

In Italy, Cucculelli and Micucci (2008) studied the relationship between family managers and firm performance in Italy. The researchers compared between two types of firms: The first type was made up of firms that continued to be managed within a family by heirs to the founders. The second type referred to firms that have outside managers or managers unrelated to the founding family. The authors found a negative relationship between firm performance and inherited family management. In addition, they found that founder-run companies outperform the sectoral average profitability before succession.

On the other hand, Mishra et al. (2001) examined the relationship between family control and firm performance among 120 Norwegian companies in 1996. They found a positive relationship between founding family control and Tobin's Q. They suggested that there is a strong relationship between family control and performance in smaller boards. In addition, they found that the presence of outside independent directors did not improve performance in family-controlled firms. Another study by Maury (2006) agreed with Mishra et al. (2001). Maury (2006) examined the relationship between family-controlled firms and firm performance among 1672 non-financial firms in Western Europe. The researchers used Tobin's Q and ROA to measure firm performance. He found that active family ownership (i.e., the family holds at least one of the top two officer positions) improved profitability. Furthermore, Barontini and Caprio (2006) investigated the relationship between family board members (as CEO and non-executive from the same family) among data from 675 publicly traded corporations in 11 countries in the Europe. They found the family CEO and family non-executive members had a significant positive effect on firm performance.

In the emerging market, Filatotchev et al. (2005) used a multi-industry dataset of 228 firms listed on the Taiwan stock exchange in 1999. This study analysed the effects of ownership structure and board characteristics on firm performance. The researchers used the ratio of market to book value (MTBV), return on capital employed (ROCE), return on assets (ROA), sales revenue and earnings per share. They did not find that family control was associated with performance measures when they used two econometrics test techniques (2SLS and

OLS). However, in another study in Taiwan, Tsai et al. (2006) studied the tenure of CEOs from a sample of 304 listed companies in Taiwan (63 firms were family controlled, 241 were not family controlled) and found that family CEOs have sufficient motivation that improves firm performance.

In Malaysia, Amran and Ahmad (2010) examined the impact of corporate governance mechanisms on family and non-family controlled companies' performance from a sample of 730 companies listed on Bursa Malaysia from 2003 to 2007. They found that family-controlled companies do have a higher firm performance as compared to non-family controlled companies.

Furthermore, Abu-Tapanjeh (2006) investigated the relationship between family board members and firm performance among 39 industrial companies in the Amman stock exchange of Jordan for the period 1992–2004. The study found that the family board members had an insignificant effect on firm performance; also, the researcher indicated that the family board members are not affecting the mechanisms of corporate governance that influence the firm as far as firm performance is concerned.

In Kuwait, Al-Saidi (2010) found a positive relationship between family directors and firm performance. Al-Saidi indicated that family board members in Kuwait are more concerned with their family name and reputation, and the new generation of family board members are more educated and qualified to manage and control the firm.

There are a number of listed companies in the Saudi market that have a substantial number of family members that act on the board of directors as either executive or non-executive members. Family board members reduce monitoring costs, eliminate the agency problem between management and shareholders, and the existence of family board members also causes the company to be run more efficiently with less debt (Fama Jensen, 1983; Al-Saidi, 2010; McConaugby et al., 2001). Hence, the literature suggests the following hypothesis for the relationship between family board members and firm performance:

H $_{3:}$ A positive relationship exists between family board members and firm performance.

4.2.6 ROYAL FAMILY BOARD MEMBERS

The royal family board member is a new variable among the board members in the Arabian Gulf countries in general and especially in Saudi Arabia. Royal family board members are very widespread in some listed companies in Saudi Arabia (Alghamdi, 2012). Fama and Jensen (1983) claimed that family-controlled firms enjoy more advantages in monitoring and discipline related to decision agents, which leads to reduced monitoring costs. Agency theory proposes that family owner-management enhances communication and cooperation within a firm and guards against opportunism, which leads to increased firm performance and reduced agency costs (Schulze et al., 2003).

The majority of royal family board members act as non-executive members (Alghamdi, 2010). Therefore, stewardship theory suggests that non-executive members may be difficult for them to understand the complexities of the company, which means that they have less knowledge about business activities, particularly as outside directors are usually part-time and may sit on a number of other boards (Weir & Laing, 2000). On the other hand, resource dependence theory predicts that royal family board members may have more resource-rich outside non-executive directors are on the board to help bring in needed resources, which leads to better performance (Peng, 2004).

Many members of the royal family are appointed as board directors and serve on boards as managerial members, which enables them to monitor the management closely, leading to decreased mismanagement and wrongdoing (Alghamdi, 2010). Alghamdi (2012) suggested that the existence of royal family board members might increase firm performance because they own large shares in the company and expose the firm to a competitive environment, which leads to improved firm performance.

For Saudi listed companies, there are a number of royal family board members that act as non-executive members. These types of board members lead to a decrease in mismanagement and wrongdoing, which may enhance a firm’s performance (Alghamdi, 2012). In addition, the majority of royal family board members have ample capital and linkages that may increase a firm’s performance (Peng, 2004; Abdullah, 2007). Hence, the literature suggests the following hypothesis for the relationship between royal family board members and firm performance:

H $_{4:}$ A positive relationship exists between royal family board members and firm performance.

4.2.7 BOARD SUB-COMMITTEES

It has been suggested that the board of directors should establish three different types of sub-committees to which they will delegate some activities. These committees should report regularly to the main board about what they have done and the areas they cover (Mallin, 2007). The Cadbury report (1992) recommended the board of directors have three sub-committees: audit, remuneration, and nomination committees.

The Smith report (2003) provided the main objective of an audit committee, which is to ensure the interests of the shareholders are protected. The Smith report (2003) outlined the main role and responsibilities of audit committees:

1. To monitor the integrity of the financial statements. For example, the audit committee should consider whether the accounting policies adopted in preparing the financial statements are appropriate.
2. To review the internal control system (if the organisation does not have a separate committee, such as a risk committee). The internal control system includes financial, operational, and compliance controls and risk management.
3. To monitor and review the effectiveness of the company's internal audit function. Internal auditors are employed by the company to monitor the internal control system.
4. To make recommendations to the board about appointment of the external auditor.
5. To monitor and review the external auditor's independence.
6. To develop and implement policy on the engagement of external auditors to supply non-audit services.

The combined code of corporate governance (2006, p. 15) states that "the board should establish an audit committee of at least three, or in the case of smaller companies two, members, who should all be independent non-executive directors. The board should satisfy itself that at least one member of the audit committee has recent and relevant financial experience." Mallin (2007) explained why the audit committee should have independent non-executive directors: to help oversee it and give assurance that the audit committee is functioning properly.

Conyon and Peck (1998) highlighted the importance of establishing remuneration committees. If this committee is absent, it provides senior executives with the opportunity to award themselves pay raises that are not congruent with shareholders' interests. The Greenbury report (1995, p. 14) stated that "to avoid potential conflict of interest, boards of directors should set up remuneration committees of non-executive directors to determine on their behalf, and on behalf of the shareholders, within agreed terms of reference, the company's policy on executive remuneration and specific remuneration packages for each of the executive directors, including pension rights and any compensation payments."

Mallin (2007) outlined the remuneration committee's roles (in the form recommended by the combined code):

1. To prevent executive directors from setting their own remuneration levels.
2. To provide a formal, transparent procedure for the setting of executive remuneration levels including the determination of appropriate targets for any performance-related pay schemes.

In addition, corporate governance codes encourage boards of directors to establish nomination committees to improve the board's effectiveness through managing its composition such as selecting qualified and independent members (Ruigrok et al., 2006). The roles of the nomination committee are to establish the benchmark that determines what skills are required of replacement or additional directors and to review the performance of the board on a regular basis (Carson, 2002). The UK combined code (2006) highlighted some important points about nomination committees, such as:

1. A majority of members of the nomination committee should be independent non-executive directors.

2. The chairman or an independent non-executive director should chair the committee.

3. The nomination committee should evaluate the balance of skills, knowledge, and experience on the board.

Klein (1998) suggested that audit and compensation (remuneration) committees be staffed by independent non-executive directors to reduce agency cost. He argued that an audit committee helps alleviate the agency problem by facilitating the timely release of unbiased accounting information by managers to shareholders and creditors, which leads to reducing the information asymmetry between insiders and outsiders and to reducing agency costs. Also, he argued that remuneration committees help alleviate the agency problem by constructing and implementing incentive and bonus schemes designed to better align managers' and owners' goals. Vafeas (1999)'s agency theory suggests that the nomination committee should be staffed by independent members to enhance effective decision control and increase performance.

Wild (1994) noted that the role of the audit committee is to oversee the financial reporting process and contribute to the integrity of financial reporting. He studied the effect of audit committee formation upon the quality of accounting reports by 260 US companies between 1966 and 1980. The researcher used market reaction (measured in terms of earnings response coefficient – the ratio of abnormal returns to unexpected earnings) before and after the companies established their audit committees. He found that earnings response coefficient increased when companies established audit committees. Also, he reported that "the formation of an audit committee is one strategy to enhance managerial accountability to shareholders" p. 370. Karamanou and Vafeas (2005) studied 275 Fortune 500 firms between 1995 and 2000. They studied the relationship between the audit committee and the quality of management earnings forecasts, as well as the extent to which market reaction to earnings forecasts was moderated by the quality of corporate governance. They found a positive relationship between market reaction to earnings forecasts and corporate governance variables, including measures of the independence, expertise, size and activity of the audit committee.

According to Newman and Mozes (1999), the compensation committee plays an important role in CEO compensation and other executive directors' compensation decisions. They studied the relationship between compensation committees and CEO compensation among 161 firms in the US. They obtained compensation data for the years 1991 and 1992 and found that the relationship between CEO compensation and firm performance is more favourable toward CEOs (the CEO receives a greater share of overall firm performance) when the firms have insiders on the compensation committee. On the other hand, Sun and Cahan (2009) studied the effect of compensation committees on the association between CEO compensation and firm performance among 812 US firms. They found that the association between CEO compensation and accounting earnings is higher when firms have a high proportion of directors on the compensation committee who are CEOs of other firms (outside directors). Also, they found that CEO compensation and accounting earnings are significantly higher for firms with a higher proportion of directors; i.e., three or more additional directorships sitting on the compensation committee.

Laing and Weir (1999) studied the relationship between board committees (remuneration and audit) and firm performance among 115 firms randomly selected from the UK quoted companies which appeared in The Times 1000 for the years 1992 and 1995. The researchers used return on assets to measure firm performance. They found that companies without board committees in 1992 that introduced a committee between 1992 and 1995 had a significantly higher return on assets than companies without board committees in both 1992 and 1995 (although the researchers do not note this, it is possible that very badly performing companies without board committees in 1992 faced difficulties in introducing such committees by 1995). In addition, a study by Brown and Caylor (2004) studied the relationship between independence of nominating committee and firm performance among 2,327 firms. The researchers used six measures to measure firm performance (return on equity, net profit margin, sales growth, Tobin's Q, and dividend yield and share repurchases). They found that independence in nominating committees is positively related to return on equity, net profit margin, dividend yield, and share repurchases.

Vafeas (1999) studied the relationship between board committees and firm value among 307 firms listed on the Forbes 1992 compensation survey that are listed in the SilverPlatter database for at least three years between 1990 and 1994. Financial firms and utilities are excluded. The researcher used two econometrics techniques (OLS and 2SLS). He found a negative (but not statistically significant) relationship between the number of board committees and firm value, that is, lower firm value is associated with more committees. However, he points out that the number of board meetings (his main variable) tends to increase after falls in firm value, and it may be that the direction of causation runs from firm value to number of committees rather than vice versa. Lam and Lee (2012) found that the nomination (remuneration) committee is positively (negatively) related to firm performance among a sample of 346 firms in Hong Kong for the period 2001-2003.

Some researchers did not find any relationship between board committees and firm performance. For example, Klein (1998) examined the relationship between committee structure and firm performance for firms listed on the S&P 500 as of March 31, 1992 and March 31, 1993. The sample consists of 485 of the original S&P firms for 1992 and 486 for 1993. The researcher used OLS regression analysis to examine this relationship and she did not find any significant statistical relationship. Also, Vafeas and Theodorou (1998) studied the relationship between board committees and firm performance among 250 firms in the UK listed in the Silverplatter database for 1994. The researchers compared the market value of the firm to the book value of the total assets (MB) as a measure of firm performance. They also did not find these committees have significant determinants of firm value. Bozec (2005) examined the relationship between board committees and firm performance among 25 state-owned enterprises in Canada during the period 1976–2000 and he found no relation between board committees and firm performance.

Overall, researchers have examined board committees in different ways: (1) the existence of particular committees and the overall number of committees, (2) factors about specific committees, such as the size, composition of membership (independence and expertise of members), and number of meetings, and (3) the initial establishment of particular committees. In some cases, researchers have incorporated various different variables for board committees in their statistical model, while in other cases they have incorporated information about board committees in overall corporate government scores or indices.

The Saudi regulations of corporate governance (2006) suggest that a suitable number of committees should be set up in accordance with the company's requirements, in order to enhance performance of the board of directors and positively affect firm performance. Also, the regulations of corporate governance in Saudi Arabia (2006) suggest that these committees should have a sufficient number of non-executive members with specific knowledge that is related to the function of the sub-committees. The literature therefore suggests the following hypothesis for the relationship between board sub-committees and firm performance:

$H_{5:}$ A positive relationship exists between board sub-committees and firm performance.

4.3 OWNERSHIP CONCENTRATION

Ownership structure is one of the most important dimensions of corporate governance mechanisms. *The Modern Corporation and Private Property,* by Berle and Means, calls attention to ownership in corporations in the United States (La Porta et al., 1999). La Porta et al. (1999) investigated the ownership structure of large corporations in 27 wealthy economies and identified five types of ownership: family or individual, state, a widely held financial institution, a widely held corporation (non-financial firm), and miscellaneous, such as cooperative, a voting trust, or a group with no single controlling investor. Alshehri (2012) noted that the problem of ownership structure can be linked to the agency problem in two ways. When ownership is divided among a large number of shareholders, the controlling interests may be not matched by those shareholders. When ownership is concentrated among a few people, groups, or families, it leads to influence management, which affects minority shareholders. The country should have a good legal system to protect the minority shareholders. La Porta (1999, p. 473) stated that:

"In these countries, controlling shareholders have less fear of being expropriated themselves in the event that they ever lose control through a takeover or a market accumulation of shares by a raider, and so might be willing to cut their ownership of voting rights by selling shares to raise funds or to diversify. In contrast, in countries with poor protection of minority shareholders, losing control involuntarily and thus becoming a minority shareholder may be such a costly proposition in terms of surrendering the private benefits of control that the controlling shareholders would do everything to keep control. They would hold more voting rights themselves and would have less interest is selling shares in the market".

Ownership concentration is one of the most widespread common ownership structures in emerging markets (Wang & Shailer, 2009). According to agency theory, the presence of concentrated ownership provides an incentive to monitor and evaluate the performance of management (Shleifer & Vishny, 1986). La Porta et al. (1998) argued that concentrated ownership protects other shareholders' interests when the legal system provides only weak protection for minority shareholders.

Xu and Wang (1999) examined whether ownership concentration had any effect on firm performance of publicly-listed companies in China in 1998. This study calculated three measures of performance: ROA, ROE, and MBR. In addition, this study measured ownership concentration by the proportion of shares hold by the top ten shareholders. It found a positive and significant relationship between ownership concentration and firm performance.

Thomsen and Pedersen (2000) examined the effect of ownership concentration on shareholder value (market-to-book value), profitability (asset returns), and sale growth of 435 of the largest European companies between 1990 and 1995. The researchers found a positive effect of ownership concentration on market-to-book value and asset returns, but the positive effect lasted only up to a certain level; after that, it showed a negative effect. There was no relationship between sales growth and ownership concentration.

Leech and Leahy (1991) investigated ownership concentration and how it can affect firm value. The researchers examined this relationship among 470 UK-listed companies between 1983 and 1985. They found that ownership concentration has a negative effect on firm performance. They suggested that ownership concentration depends on firm size, diversifiable risk, and product diversification.

In contrast, Pedersen and Thomsen (1999) discussed the effect of ownership concentration in the largest companies in 12 European countries on firm performance between 1990 and 1993. Their study found that ownership concentration does not have any significant effect on return on equity. They also found that ownership concentration decreases with firm size.

There are some studies that discussed the relationship between ownership concentration and firm performance in developing Arab countries. Al-Shiab and Abu-Tapanjeh (2005) investigated 50 of the largest Jordanian industrial companies listed on the Amman Stock Exchange and the impact of ownership concentration on ROA and market-to-book value of equity as measures of performance from 1996 to 2002. This study found a nonlinear and significant effect of ownership concentration on market-to-book value but a negative and insignificant effect on ROA.

Moreover, Omran et al. (2008) investigated the relationship between ownership concentration and firm performance among a sample of 304 firms from various Arab countries (Egypt, Jordan, Oman, and Tunisia). The researchers used ROA, ROE, and Tobin’s Q to calculate firm performance. The researchers used the 2SLS regression technique and found a positive significant at a level of 1% between Tobin’s Q and ownership concentration and no significant effect of ownership concentration on ROA and ROE. However, when excluding financial institutions from the full sample, they found the same result for ROA and ROE, and a positive significant effect on Tobin's Q at a level of 5%.

Ownership concentration can be understood as referring to the existence of a small number of entities or individuals who, between them, own a substantial proportion of the company's equity. The ownership concentration can be also referring to different types of owners such as managers, families, governments, banks, and corporations. La Porta et al. (1998) suggest that in countries with poor investor protection, ownership concentration becomes a substitute for legal protection, because only large shareholders can hope to receive a return on their investment (Burkart and Panunzi, 2006). La Porta et al. (1998) investigated why ownership tends to be more concentrated in countries that have poor investor protection and explained this was primarily due to two reasons: first, large shareholders or dominant shareholders who monitor the managers might need to own more capital and shares to exercise their control rights and thus to avoid being expropriated by the managers; and second, small investors in the countries that are poorly protected might be willing to buy shares in companies at low prices that then make it unattractive for corporations to issue new shares to the public. The concentrated ownership in Saudi Arabia is classified into managers, families, individuals, foreign, financial and non-financial corporations, and governments. In turn, we consider each type of ownership in the following sections.

4.3.1 MANAGERIAL OWNERSHIP

Jensen and Meckling (1976) argued that if the share ownership of a manager decreases, the agency cost will be generated by divergence between his interest and the interests of outside shareholders. Also, Jensen and Meckling (1976) stated that when an owner-manager's percentage of common stock falls, this fraction's claim on the outcome falls and tends to encourage him to appropriate another resource in the form of perquisites, which forces minority shareholders to expend more resources in monitoring his behaviours. Agency theory suggested that the agency cost may be reduced if managers increase their common stock ownership of the firm to better align their interests with those of outsider shareholders (Crutchley & Hansen, 1989).

According to Dinga et al. (2009), two main hypotheses describe the relationship between managerial ownership and firm performance: the convergence of interest hypothesis and the entrenchment hypothesis. The convergence of interest hypothesis proposes that the equity ownership of managers leads to aligning the interests of shareholders and managers, and when the proportion of equity owned by managers increases, the interests of two parties (managers and outside directors) align (Dinga et al., 2009; Ntim, 2009). According to Ntim (2009, p. 117), "directors who own large blocks of shares have additional incentive to actively monitor managerial actions that can help reduce agency cost and increase firm financial performance".

However, another hypothesis, the entrenchment hypothesis, views the situation differently. According to Morck et al. (1988), the high level of managerial ownership may lead to entrenchment, which creates difficulties for outside shareholders to monitor the firm (as cited in Short & Keasey, 1999). Stulz (1988) suggested that this is a positive relationship between firm value and managerial ownership for lower fractions of voting rights, and it is negatively related when the fractions are large (as cited in Dinga et al., 2009).

A large body of work examined the relationship between managerial ownership and firm performance using several measures of firm performance. The first scholars in this area found a non-linear relationship between these two variables (managerial ownership and firm performance). Morck et al. (1988) studied the relationship between managerial ownership and market valuations of firms in a 1980 cross-section of 371 Fortune 500 firms in the US. The researchers used Tobin's Q and profit rate to measure firm performance and applied piecewise linear regression to examine this relationship. The researchers found a positive relationship between managerial ownership and firm performance at a 0–5% ownership range and a negative relationship between 5–25%—plus a positive effect in firm performance beyond the 25% level. The main result of the study was a non-linear relationship between managerial ownership and firm performance.

Additionally, McConnell and Servaes (1990) supported the result found by Morck et al. (1988) by using the same data. They investigated the relationship between Tobin's Q and managerial ownership among 1,173 firms for 1976 and 1,093 firms for 1986 in the US. The researchers found a non-linear relationship between firm value and managerial ownership; they found a significant curvilinear relation. Another study by McConnell and Servaes (1995) investigated the relationship between Tobin's Q and equity ownership in 1976, 1986 and 1988 in the US for high-growth firms and low-growth firms. They found that the fraction of shares held by managers is more closely tied to corporate value for low-growth than for high-growth firms.

In addition, Short and Keasey (1999) studied this relationship in the UK. They investigated the relationship between the percentage of equity shares held by management and firm performance among UK firms in the London Stock Exchange for the period 1988–1992. They used two variables to measure firm performance (the return on shareholders' equity and a valuation ratio). The researchers used OLS regression to examine this relationship, finding a non-linear relationship between performance and managerial ownership. Another study by Davies et al. (2005) examined the relationship between managerial ownership and firm value in the UK for 1996 and 1997 by using Tobin's Q as a measure of firm value. They found a non-linear relationship between firm value and managerial ownership.

Subsequent scholars to examine this relationship found a positive relationship between managerial ownership and firm performance. For example, Earle (1998) investigated the impact of managerial ownership on the productivity performance of Russian industrial enterprises in 1994. The researcher used an OLS regression estimate to examine this relationship and found a positive relationship between firm performance and managerial ownership. In addition, Claessens and Dajankov (1999) studied the effects of managerial equity holding on firm performance among 706 Czech firms over the period 1993–1997. The researchers used profit margins and labor productivity to measure firm performance. The main result of this study was that equity holding by insiders exerts a positive effect on firm performance.

Chen et al. (2003), investigated the relationship between managerial ownership and Tobin's Q among 123 Japanese firms from 1987–1995. The researchers used an OLS econometrics technique to examine this relationship. They used a regression model to distinguish between two hypotheses (convergence of interests and entrenchment). The Ordinary Least Squares (OLS) regression model showed a positive relationship between Tobin's Q and managerial ownership.

Kaserer and Moldenhauer (2008) also contributed to the discussion, addressing in their research the question of whether inside ownership affects firm performance. The researchers examined this relationship between inside ownership and firm performance using various measures of performance (stock price performance, a market-to-book ratio and returns on assets) among 648 firms in Germany for the years 2003 and 1998. The researchers used two econometrics techniques (OLS and 2SLS) to examine this relationship. Their study found a positive and significant relationship.

Lastly, another study in Greek by Kapopoulos and Lazaretou (2007) studied the impact of managerial ownership on firm performance among a sample of 175 Greek listed firms in 2000 by using the same econometrics techniques (OLS and 2SLS) used by Kaserer and Moldenhauer (2008). They used Tobin's Q and an accounting profit rate to measure firm performance. Their study also found a positive and significant relationship between these two variables.

In contrast, some scholars examined the same relationship between managerial ownership and firm performance and found a negative relationship. For example, Sanda et al. (2005) investigated the relationship between managerial ownership and firm performance in a sample of 93 Nigerian listed firms from 1996 to 1999. The researchers used a price-earnings ratio, returns on assets, returns on equity and Tobin's Q to measure performance as a dependent variable. They concluded that a negative relationship exists between managerial ownership and firm performance.

Also, Haniffa and Hudaib (2006) examined the relationship between managerial ownership and firm performance in a sample of 347 companies listed on the Kuala Lumpur Stock Exchange in 1996–2000. They found a negative relationship between firm performance and managerial ownership. In addition, they stated that "managerial ownership seemed to be detrimental to accounting performance" (p. 1057). However, Haniffa and Hudaib (2006) found that the mean managerial ownership in their sample was 34.53%, much greater than was the case in most studies using US data.

Finally, some scholars found no relationship between these two variables whatsoever. For example, Curcio (1994) investigated the relationship between managerial ownership and firm performance using a panel dataset of 389 UK manufacturing companies. The researcher used two measures of firm performance, Tobin's Q and total factor productivity growth. He found that managerial ownership was not related with Tobin's Q and was a positive effect on productivity growth but not highly significant.

Also, another study in the UK, developed by Vafeas and Theodorou (1998), studied the impact of managerial ownership on firm performance in a sample of 250 publicly traded firms in the UK. The researchers measured performance by using the market value of the firm compared to the book value of the total assets (MB). They supported the result found by

Curcio (1994). They concluded that percentage of stock ownership by management was unrelated to firm performance.

Faccio and Lasfer (1999) investigated the relationship between managerial ownership and firm value among 1,650 non-financial companies in the London Stock Exchange from June 1996 to June 1997. Their study used the management entrenchment hypothesis to test this relationship by splitting these companies into high-growth and low-growth groups, using Tobin's Q, PE, ROE and ROA to measure firm performance. The main result of this study showed that the relationship between firm performance and managerial ownership was weak or non-existent. In a developing country, El Mehdi (2007) analysed the relationship between ownership structure and firm performance by using 24 firms listed on the Tunisian stock exchange for 2000–2005. He found that CEO shareholding was associated with firm performance (measured using a variation of Tobin's Q), but that the shareholding of other directors (who were mainly managers, as El Mehdi found that non-executive directors were uncommon in Tunisia during the period of his study) was not associated with firm performance.

Overall, the majority of studies suggest that there is a positive relationship between managerial share ownership and firm performance, where performance is measured using a wide range of metrics. This is supported to some extent by the only study to date of ownership structure and firm performance in a MENA (Middle East and North Africa) country (El Mehdi, 2007). Other research findings imply that the relationship may not be linear over the full range of possible managerial shareholdings. Hence, the literature suggests the folloing hypothesis for the relationship between managerial ownership and firm performance:

H_6: A positive relationship exists between managerial ownership and firm performance.

4.3.2 FAMILY OR INDIVIDUAL OWNERSHIP

Agency theory argues that ownership concentration with a large shareholder (family or individual) will lead to more effective monitoring (Klein et al., 2005). Jensen and Meckling's (1976, as cited in Miller and Breton-Miller, 2006) agency theory argues that ownership concentration leads to reduced monitoring costs because large owners (family or individual) possess the incentive and expertise to monitor the managers. According to Anderson and Reeb (2003, p. 1305), "the family's wealth is so closely linked to firm welfare, families may have strong incentives to monitor managers and minimize the free-rider problem inherent with small, atomistic shareholders".

La Porta et al. (1999) studied the ownership structure of large corporations in 27 wealthy economies around the world, providing examples of individual or family ownership. They mentioned that the fourth most valuable company in the US is Microsoft, which has three large individual shareholders: cofounders Bill Gates (23.7% of the votes as well as shares), Paul Allen (9%), and Steven Ballmer (5%).

McConaugby et al. (2001) also investigated the relationship between family ownership and performance. They found that family ownership exercised a positive impact on firm performance. In addition, Villalonga and Amit (2006) studied how family ownership affected firm value in Fortune 500 firms from 1994 to 2000 in the US. They found that family ownership created value for firms only when the founder served as the CEO of the family firms or as the chairperson with a hired CEO. In addition, they suggested that "the classic owner-manager conflict in non-family firms is more costly than the conflict between family and non-family shareholders in founder-CEO firms" (Villalonga & Amit, 2006, p. 385).

Pukthuanthong et al. (2013) investigated the relationship between family ownership and firm performance among Canadian companies listed on the Toronto Stock Exchange (TSX) between 1999 and 2007. They found that family ownership helps resolve agency conflicts between ownership and management and, in turn, enhances firm value.

Barontini and Caprio (2006) investigated the relationship between ownership structure and firm performance in 675 publicly traded corporations in 11 countries in Europe. The researchers used market valuation (Tobin's Q) and operating performance (ROA) to measure firm performance. Their results indicated that family ownership had a positive effect on firm performance. Martinez et al. (2007) studied the impact of family ownership on firm performance for a sample of 175 firms that regularly operate in Bolsa de Comercio de Santiago, the main Chilean stock exchange. The researchers used three different measures of firm performance: ROA, ROE, and Tobin's Q for a ten-year period (1995–2004). They found that family-controlled firms were better performers than non-family-controlled companies.

In France, Corstjens et al. (2004) compared the economic performance of French publicly quoted family-owned and non-family-owned firms for the period from 1993 to 2002. The researchers used Tobin's Q and ROA to measure firm performance and found that French family-owned firms offered a significantly higher return on assets than did non-family firms, and they did not find any significant difference in Tobin's Q between French family and non-family firms.

Cueto (2008) investigated the relationship between ownership structure and firm performance from 2000 to 2006 across various countries (Brazil, Chile, Colombia, Peru, and Venezuela). The researcher found that the investors preferred a dominant family group shareholder rather than institutional investors or a government agency because family members owned more internal information and could lead the firm more easily with their experience (Shyu, 2011).

In China, Xu and Wang (1997) investigated the relationship between individual ownership and firm performance of publicly listed stock companies in China. They found that individual ownership has an insignificant relationship with firm profitability. They mentioned that the reason for this insignificant relationship is that publicly traded corporations in China suffer from the traditional free-rider problem, and individual shareholders have no incentive and no capability to monitor and influence the behaviour of management.

In Taiwan, Chu (2011) examined the relationship between family ownership and firm performance by considering the influence of family management, family control, and family size among 786 public family firms in Taiwan from 2002 to 2007. The researcher used ROA to measure firm performance. He found a positive relationship between family ownership and firm performance. Shyu (2011) investigated the influence of family ownership in Taiwan on firm performance using 465 Taiwanese listed companies. He used ROA and Tobin's Q to measure performance. The researcher found some interesting results: increasing family ownership led to enhanced firm performance, family members possessed both internal information and the ability to foresee the prospects of a given firm more easily, the profitability of a firm (ROA) increased with an increase in family holding (reaching its peak when family ownership was approximately 30%), and the relationship between firm profitability and family appeared to take on an inverse U-shaped curve.

Abdullah et al. (2011) investigated the impact of group and family ownership on the financial performance of a sample of firms listed on the Karachi stock exchange from 2003 to 2008. They applied different models of econometrics (OLS and 2SLS) to examine this relationship and found that the Tobin's Q of family-owned firms was larger than that of non-family owned firms. Moreover, the ROA suggested that family ownership did not result in increased efficiency in the utilization of assets or cost of reduction.

Zeitun and Tian (2007) examined the impact of ownership structure on firm performance on a sample of 59 publicly listed firms in Jordan from 1989 to 2002. This study calculated four ratios to measure firm performance (ROE, ROA, Tobin's Q, and market-to-book value). They stated that individual ownership has no incentive and no capability to monitor and influence the behaviour of management, which leads to bad performance. In addition, in Jordan, Al-Shiab and Abu-Tapanjeh (2005) examined the ownership structure on firm performance in 50 of the largest Jordanian industrial companies listed on the Amman stock exchange from 1996 to 2002. They found a negative relationship between individual ownership and firm performance. Hence, the literature suggests the folloing hypothesis for the relationship between family or individual ownership and firm performance:

H_7: A positive relationship exists between family or individual ownership and firm performance.

4.3.3 GOVERNMENT OWNERSHIP

Shleifer and Vishny (1986) argue that large blockholder ownership may work as a device to monitor and centralize management and improve firm performance. Craswell et al. (1997) agree that it creates a great incentive to monitor management; whether institutions or individuals, large blockholders can achieve cost effectiveness due to their expertise. Resource dependence theory suggests that blockholder ownership (such as government ownership) provides firms the advantages of counsel, legitimacy, communication channels with external organizations, and preferential access to important elements outside the firm (Hillman and Dalziel, 2003).

Government investment in firms can achieve social and economic goals beyond profitability (Aljifri and Moustafa, 2007). Sun et al. (2002) summarise three major roles it plays:

- The signalling effect. Government ownership can send signals to investors. For example, selling a small portion of a company to the public can be positive signal that the government is committed and credible.
- The monitoring role. Government can contribute to firm performance through active monitoring. However, the feasibility of this is a practical problem.

- The policy role. The government may give firms important business connections.

Zeckhauser and Pound (1990) documented that large shareholders, such as governments, corporations and families, help solve an information problem in capital markets by monitoring management expected to produce significantly higher growth rates. However, if large shareholders improve firm performance, why do not all firms have them? Zeckhauser and Pound suggested that when the capital market is fully efficient, large shareholders would be most likely to take positions in firms that would otherwise exhibit poor performance. Thomsen and Pedersen (1998) said the traditional argument for government ownership is that monopoly power and large economics of scale overcome market failures or income distribution problems. However, Wiwattanakantang (2001) corrected the old view of government ownership, and replaces it with the idea of a monopoly or regulated duopoly that may give rise to superior performance. Government ownership has the power to monitor management, protect minority shareholders and supply firms with funds to support the capital market and infrastructure, especially in developing markets (Wiwattanakantang, 2001).

Boardman and Vining (1989) found a significant negative relationship between government ownership and firm performance in North America. Cueto (2008) found a similar one during the period of 2000-2006 across various Latin American countries. Government ownership, the researchers said, provides the firm with poor monitors and does not pursue investment projects with positive net present value.

Xu and Wang (1999) examined the impact of ownership structure on firm performance in publicly-listed companies in China, using pooled firm-level data for 1993 through 1995. Their study found a positive relationship between institutional government ownership and firm performance by using market-to-book value ratio, return on equity (ROE), and return on assets (ROA) to calculate firm performance. This study suggested that institutional government ownership can and does monitor and control management. Sun et al. (2002) reinforce this result, finding a similar relationship among all companies listed on the Shanghai Stock Exchange and Shenzhen Stock Exchange from 1994 to 1997.

However, other studies in China show conflicting results. Wei and Varela (2003) investigated the relationship between government equity ownership and firm performance for Chinese privatized firms in 1994 (164 firms), 1995 (175 firms), and 1996 (252 firms). The researchers used Tobin's Q, monthly stock returns (MSR), and the ordinary least square test (OLS).

Tobin's Q's relationship with government ownership is convex (non-linear). It decreases as government ownership increased from the lowest level, but then increases after the ownership reached an inflection point. The relationships with MSR were insignificant. Also, Bai et al. (2004) examined the relationship between firm performance and institutional government ownership in China from 1999 to 2001, and found it negative.

Sulong and Nor (2010) examined it using panel data analysis of 403 firms listed on the Bursa Malaysia over a four-year period from 2002 to 2005. The researchers used a generalized least square (GLS) estimation technique to find a significant positive relation between institutional government ownership and Tobin's Q.

In Arab countries, reports of the relationship are similarly mixed. Omran et al. (2008) investigated 304 firms from different sectors in Egypt, Jordan, Oman, and Tunisia, from 2000 to 2002. They found that institutional government ownership has a positive effect on ROA, ROE (accounting measures), and Tobin's Q (market measure). Aljifri and Moustafa (2007) examined 51 firms for the year of 2004 in the UAE and find a similar positive relationship.

However, Zeitun and Tian (2007) studied 59 publicly listed firms in Jordan from 1989 to 2002, working with ROE, ROA, Tobin's Q, and market-to-book value. Their study found a significant negative significant relationship between government ownership and firm performance. Furthermore, they suggested that reducing government ownership can increase firm performance, but will also cause some firms to go bankrupt, at least in the short term. They recommended governments pursue privatization reform and social security to minimize impact of such liquidations.

The Saudi Arabian government owns significant shares in some of the listed companies in the capital market. Government ownership can contribute to a firm's performance through active monitoring (Sun et al., 2002). In addition, government ownership also protects minority shareholders and supplies firms with funds to support the capital market and infrastructure (Wiwattanakantang, 2001). Hence, the literature, especially in emerging markets, suggests the following hypothesis for the relationship between government ownership and firm performance:

***H_8*: A positive relationship exists between government ownership and firm performance.**

4.3.4 FOREIGN OWNERSHIP

Foreign investor ownership can reduce expropriation problems because the foreign investor is under greater government scrutiny, which discourages foreign investors from disregarding minority shareholder investors (Dharwadkar et al., 2000; Fraedrich & Bateman, 1996). Foreign investors have more of the necessary experience and skills of governance to reduce monitoring and agency cost problems as well as provide corporations with sufficient resources (Dharwadkar et al., 2000; Djankov, 1999; Frydman et al., 1997). In addition to the principal-agent conflict, the principal-principal conflict in the emerging market is also a problem (Young et al., 2008). The principal-principal conflict may produce between foreign ownership and domestic ownership. This conflict appears within weak governance systems with little legal protection from large owners (foreign or domestic) that control the firms and deprive other owners of the right to appropriate returns on their investments (Claessens et al. 2000; Lemmon and Lins 2003, as cited in Douma et al., 2006).

According to resource dependence theory, foreign investor ownership is endowed with good monitoring capabilities and provides firms with tangible and intangible resources, which are costly or sometimes difficult to obtain (Douma et al., 2006). Firms with foreign shareholders are endowed with superior technical and managerial expertise, and organisational and financial resources (Sulong and Nor, 2010). Djankov and Hoekman (2000) suggest that foreign ownership should be associated with provision of knowledge and skills that may be provided the firms.

In Greece, Dimelis and Louri (2002) analysed the relationship between foreign ownership and performance by using a sample of 4,056 manufacturing firms operating in Greece in 1997. The researchers used labour productivity to measure firm performance. This study found that a higher degree of foreign ownership led to more efficient production. In addition, Barbosa and Louri (2005) found multinational firms operating in Greece are significantly more profitable than Greek-owned firms

In Norway and Sweden, Oxelheim and Randøy (2003) investigated the relationship between foreign ownership and firm performance and found a positive relationship between the two. They suggested that board members from Anglo-American countries enhance the international orientation of the firms and serve as a catalyst for further globalization of the corporation, which leads to enhanced firm performance.

In Germany, Lehmann and Weigand (2000) investigated the relationship between foreign ownership and firm performance (ROA) among 361 German corporations that operated during the period of 1991–1996. The researchers used panel regression to examine this relationship, and the main result suggested a negative relationship between foreign ownership and ROA.

Gedajlovic et al. (2005) used data from the fiscal years of 1996–1998 for 247 of Japan's largest manufacturers. They evaluated the extent to which a firm's investment behaviour and financial performance are influenced by its ownership structure. They found no relationship between the percentage of shares held by foreign shareholders and ROA. Also, they found stock ownership by foreign shareholders to be associated with higher dividend payouts.

Bai et al. (2004) also found a positive significant relationship between foreign investors and market valuation (Tobin's Q) in China for the period of 1999–2001. Wei et al.'s study (2005) supported these results. They investigated the relationship between ownership structure and firm value across a sample of 5,284 firms years of China's partially privatized, formerly state-owned enterprises (SOE) from 1991–2001. They found that foreign ownership of China's privatized firms is positively and significantly related to firm value. Wei et al. (2005) believe this finding indicates that foreign investors can monitor and positively influence management of the firm, force management to act more consistently with firm value maximization, allow access to international capital markets, and access advanced technology and international managerial talents.

Chhibber and Majumdar (1999) found that the existence of the foreign ownership in Indian firms is positively related to a high degree of resources and technology skills, which enhance firm performance. Douma et al. (2006) validated this study. They investigated the impact of foreign investor ownership on firm performance in 1,005 Indian firms for the period of 1999-2000. This study used return on assets (ROA) and Tobin's Q to measure firm performance. It found that the coefficient of foreign ownership is positively and significantly related to ROA and Tobin's Q.

Imam and Malik (2007) investigated the relationship between firm performance and foreign ownership in Bangladesh. They found a positive relationship between the two. They note that foreign holdings are increasing in firms with good governance, and through these good governance practices, firms will improve by performing better for all of their stakeholders. Moreover, a more recent study by Sulong and Nor (2010) also investigated how foreign ownership affects firm performance. They used a panel data analysis of 403 firms listed on the Bursa Malaysia for a four-year period from 2003–2005. Their study found that foreign ownership is statistically significant and is associated with enhanced firm value (Tobin's Q).

Al-Shiab and Abu-Tapanjeh (2005) examined the ownership structure and firm performance of 50 of the largest Jordanian industrial companies listed in the Amman stock exchange for the period of 1996-2002. They found a negative, but insignificant, relationship between the two. Also, Omran et al. (2008) failed to find any significant relationship between foreign investors and firm performance in Arab countries (Egypt, Jordan, Oman, and Tunisia) for the period of 2000-2002 by using ROA, ROE, and Tobin's Q to calculate firm performance.

Most of the studies that concerned the relationship between foreign ownership and firm performance focus on the emerging market. There are a number of reasons for foreign ownership to be concentrated in this area. The R&D capital of foreign-owned firms is greater than that of domestic firms. Also, foreign-owned firms can benefit from the managerial experience and distribution networks of their foreign owners (Yudaeva et al., 2000). The existence of foreign investors in the emerging market enhances the appreciation of its technical infrastructure in these countries (El Mehdi, 2007). Hence, the literature, especially in emerging markets, suggests the following hypothesis for the relationship between foreign ownership and firm performance:

***H_9*: A positive relationship exists between foreign ownership and firm performance.**

4.3.5 FINANCIAL FIRMS OWENERSHIP

Bank and financial institutions play a pivotal role in business, because they are the largest source of external funds for firms (Ang et al., 2000). External shareholders can enforce a high level of productivity (Nickell et al., 1997). Ang et al. (2000) explained how bank ownership reduces agency cost. By incurring monitoring costs to safeguard their loans, banks make firms use assets and reduce perquisite consumption. This leads to improved firm performance. Moreover, Ang et al. (2000) highlighted that banks and financial institutions have the skills and knowledge to enforce good monitoring. Also, financial firm ownership, especially when concentrated, can help firms in crisis by offering low-interest loans themselves or connecting firms with other loan sources (Heugens et al., 2009). Regarding the resource dependence theory, the financial firms ownership seeks to maximize organizational autonomy. Organizational leaders use many strategies to manage their external constraints and dependencies with good financial resources (Johnson, 1995).

Regarding the developed market, there is a wealth of literature indicating the vital role of financial institutions in firm performance. Prowse (1992) examined the ownership structure of keiretsu and independent firms in Japan from 1979 to 1984. The researcher used OLS regression estimates to examine this relationship. The result of this study suggested that financial institutions help stabilize profits in independent Japanese firms, but not in keiretsu. Nickell et al. (1997) investigated the impact of financial institutions on the productivity of 580 UK manufacturing companies from 1982 to 1994 and found a positive effect. In Spain, banks play a key role in firm ownership. When Spanish banks are part owners of a firm, they can internalise financial relationships (Nanka-Bruce, 2006).

Gorton and Schmid (2000) investigated the influence of bank equity ownership in Germany, comparing two different periods (1974 and 1985) to examine the effect of bank equity ownership on the firms' return on assets (ROA) and return on equity (ROE). The 1974 sample contained 88 companies and indicated a positive effect. The 1985 sample contained 57 firms, and indicated that banks' equity ownership no longer had the same power as in 1974. Lehmann and Weigand (2000) studied the same relationships among 361 German corporations. They defined large shareholders as those with at least five percent of the firm's voting capital. Their study found that if firms were owned by families, financial institutions, or a mix, they were significantly more profitable than other groups.

On the other hand, a number of studies have found a negative relationship between financial institution and firm performance. Morck et al. (2000) found such a negative relationship between equity ownership by banks and Tobin's Q in Japanese firms. They explained the cause as increased interest costs for firms. Baert and Vennet (2009) studied 2,851 European-listed firms using Tobin's Q for the period from 1997 to 2006. Their results agreed with the results found by Morck et al. (2000).

Lin et al. (2009) found that bank ownership hurt firm performance in an emerging market: companies listed in the Shanghai Stock Exchange and Shenzhen Stock Exchange in China from 1994 to 2004. They used ROA, ROE and Tobin's Q to calculate firm performance, and attributed the negative effect to inefficient borrowing and investment systems.

Finally, Abdel Shahid (2003) investigated the relationship between ownership structure and firm performance among the 90 most actively listed companies on the Cairo & Alexandria stock exchange at the end of 2000. He found it insignificant. The study indicated that ownership concentration affected stock performance less than economic and market conditions such as the South East Asian crisis, and the lack of disclosure of listed companies led to insignificant results. Hence, the literature, especially in emerging markets, suggests the following hypothesis for the relationship between financial firms ownership and firm performance:

H_{10}: A positive relationship exists between financial firms ownership and firm performance.

4.3.6 NON-FINANCIAL FIRMS OWNERSHIP (CORPORATIONS)

La Porta et al. (1998) argued that large blockholders in countries with weak legal protection for minority shareholders solved the agency's problem and received a good return on investment. Gorton and Schmid (2000) argued that outside block shareholders played a vital role as monitors of management because the size of these external shareholders gave them more incentive to oversee management and reduce the free-rider problems of small shareholders, which led to a reduction in the cost of monitoring.

Holderness and Sheehan (1988) analysed the relationship between corporations' ownership who held equity in their firms and firm performance for one hundred fourteen NYSE or AMEX-listed companies for the period 1979–1984. This study used accounting rate-of-return and Tobin's Q to measure firm performance. Their results found that a corporation's ownership did not have any effect on firm performance. These results are consistent with the results found by Demsetz and Lehn (1985), which reported no significant relationship between large ownership and accounting profit rates.

Also, Mehran (1995) investigated the relationship between corporations that own at least five percent of common stock of the company and firm performance among 153 randomly selected manufacturing firms in 1979–1980 in the US. The researcher used Tobin's Q and ROA to calculate firm performance. He found no significant relationship between firm performance and corporation ownership.

Moreover, Gorton and Schmid (2000) investigated the relationship of nonbank blockholders and accounting performance (ROA and ROE). They researched two different periods in Germany: 1974, with eighty-eight companies, and 1985, with fifty-seven companies. The researchers stated that "nonbank blockholders may be so powerful that they monitor management and banks, preventing banks from falling prey to their conflicts-of-interest" (p. 15). The main result of this study showed that in 1974 nonbank blockholders did not have any effect on firm performance, while in 1985, they did affect firm performance.

Other scholars found a positive or negative relationship between equity ownership by corporate blockholders and firm performance. For example, Nickell et al. (1997) investigated the role of non-financial ownership on productivity growth rate using data from around 580 UK manufacturing companies for the period 1982–1994. They found a negative effect of non-financial ownership equity on productivity growth.

However, Prowse (1992) discussed the relationship of many types of external ownership structures and their effects on firm performance in Japan for the period 1979–1984. The researcher used profit instability and found the coefficient is positive in non-financial ownership-equity regression. In addition, Morck et al. (2000) reported that a positive relationship exists between equity ownership by corporate blockholders and firm value in Japan. They studied this relationship between two variables: ownership by corporate blockholders and Tobin's Q. Morck et al. (2000) stated that this is a positive relationship, consistent with the hypothesis of Shleifer and Vishny (1986), which stated that the large blockholders are a way to solve the free-rider problems.

Zeitun and Tian (2007) examined the impact of ownership structure on firm performance on a sample of fifty-nine publicly listed firms in Jordan from the period 1989–2002. This study calculated four ratios to measure firm performance: ROE, ROA, Tobin's Q, and market-to-book value. Their study found that non-financial ownership (companies) did not seem to have any significant impact on firm performance.

In Jordan, Al-Shiab and Abu-Tapanjeh (2005) examined the ownership structure on firm performance in 50 of the largest Jordanian industrial companies listed in the Amman stock exchange for the period 1996–2002. They found a positive relationship between non-financial ownership and firm performance, but no significant relationship, while the correlation between non-financial ownership and market-to-book value was found to be positively significant.

In Egypt, Abdel Shahid (2003) investigated the relationship between ownership structure and firm performance among 90 of the most-actively listed companies on the Cairo & Alexandria stock exchange for the period at the end of 2000. The study found a highly positive significant relationship between various firm performances (ROE and ROA) and non-financial ownership. Hence, the literature, especially in emerging markets, suggests the following hypothesis for the relationship between non-financial firms ownership and firm performance:

H_{11}: A positive relationship exists between non-financial ownership and firm performance.

4.4 SUMMARY

This chapter highlights the previous literatures that discuss the relationship between corporate governance mechanisms and firm performance. The literature suggests that the relationship between the structure of the board of directors and firm performance is mixed. In addition, the previous studies discussed how the board of directors, among several structures, reduces the agency problem by using a small board size, and through the use of outside non-executive directors, with more concern on family board members. Based on the prior literature, a series of hypotheses linking corporate governance mechanisms based on the board of directors with firm performance has been developed.

Another part of this chapter discusses previous studies concerning the ownership structure. The literature focused on two types of ownership (inside and outside) and their effect on firm performance. Moreover, this chapter presents several studies that used varied measures of firm performance, such as ROA, ROE, and Tobin's q. Based on the prior literature, a series of hypotheses linking ownership structure with firm performance has been developed. The next chapter will provide detailed investigations of the Saudi Arabian environment.

5 THE ENVIRONMENT OF SAUDI ARABIA

5.1 INTRODUCTION

In order to understand the environment in which this research is situated, this chapter presents some general background information about the Kingdom of Saudi Arabia, one of the largest countries in the Middle East and North Africa and one of the more active of the emerging markets. It is divided into eight sections. Section 5.2 presents a brief introduction on Saudi Arabia. Section 5.3 provides a brief description of the Saudi political system, while section 5.4 sheds light on important aspects of its legal system. Section 5.5 reveals the economic system of Saudi Arabia with a focus on the country's development plans. Section 5.6 offers a brief description of the monitoring bodies and the following section sheds light on the regulations and law that set and regulate companies in Saudi Arabia. Section 5.8 provides a description of the Saudi stock market including its historical background and the development of the new Saudi capital market (Tadawul). Section 5.9 focuses on the corporate governance regulations in the Kingdom, after which section 5.10 provides a brief summary of the chapter.

5.2 GENERAL BACKGROUND

On 23 September 1932, King Abdulaziz Al-Saud (1880-1953) founded the Kingdom of Saudi Arabia (Falgi, 2009). The Kingdom is located on the Arabian Peninsula in the southwest corner of Asia. It is the largest country in the Middle East and the fourteenth largest country in the world (Albarrak, 2011) and is about one-fourth the size of the United States, with a total area over 2,150,000 km^2 (830,000 square miles) and is covered almost 80% of the Arabian Peninsula (Ministry of Economy and Planning, 2012 a). Desert covers more than half of the total area (Ministry of Economy and Planning, 2012 a). The country had a total population 25 million in 2009 (Albarrak, 2011).

Figure 5-1 Map of Saudi Arabia

Source: Ministry of Economy and Planning (2012 e) (as cited in Alshehri, 2012)

The capital city is Riyadh, located in the centre of the Kingdom and contains the headquarters of the Gulf Cooperation Council (GCC) (Ministry of Economy and Planning, 2012 b). Saudi Arabia has the two holiest cities in the Muslim world, Makkah and Madinah. Makkah is the city of birth of the Prophet Mohammed, and the place where Muslims travel in pilgrimage and is, also, the direction of Muslims' prayers. Madinah is the city of the Prophet Mohammed where he emigrated and lived. Because of these two holy cities, the Kingdom of Saudi Arabia has a special position in the Islamic world (Falgi, 2009).

The religion is Islam which influences all aspects of life in the Kingdom, including business, company law, accounting practices and professions (Alkhtani, 2010). Arabic is the official language and is used in drafting documents and contracts (Basheikh, 2002). There are two festival days in Saudi Arabia and in the Islamic world in general, Eid Alfiter (after Ramadan) and Eid Aladha (during the Pilgrimage).

Table 5-1 Key Indicators

Total population 2012	29,195,895
Population growth rate 2012	2.90 %
Population density (person/sq km) 2012	14.6
Saudi population 2012	19,838,448
Saudi population growth rate 2012	2.21 %
GDP growth at constant prices 2012	6.81 %
Per capita GDP at current prices in 2012 (SAR)	93,417
Private sector's contribution to GDP at constant prices for 2012	58.20 %
Proportion of private sector growth for 2012 at constant prices	7.50 %
Proportion of non-oil exports to imports 2012	34.40 %
Growth of exports of goods and services for 2012	8.14 %
Growth of imports of goods and services for 2012	5.23 %
Exports contribution to GDP for 2012 at current prices	55.90 %
The cost-of-living index 2012	122
Change in the cost-of- living index (inflation) for 2012	2.90 %
Unemployment rate 2012	5.50 %
Saudi's unemployment rate 2012	12.10 %
Employment as percentage of population 2012	35.60 %
Revised economic participation rate 2012	39.20
Infants mortality rate (per thousand live births) 2012	16.2
Gross enrolment rate in primary education 2011	106 %
Net enrolment rate in primary education 2011	96.60 %

Source: Central Department for Statistics and Information (2012)

5.3 THE POLITICAL SYSTEM IN SAUDI ARABIA

The political system of Saudi Arabia is monarchical. According to the Basic Law of Governance:

> Governance shall be limited to the sons of the Founder King 'Abd al-Aziz ibn 'Abd ar-Rahman al-Faysal Al Sa'ud, and the sons of his sons. Allegiance shall be pledged to the most suitable amongst them to reign on the basis of the Book of God Most High and the Sunnah of His Messenger (PBUH) (1992, Article 5-b).

The monarchical system is centralized (Alghamdi, 2012) with the King as the authority for legislation (Albarrak, 2011). The King derives authority from the Holy Quran and the Sunnah of the Prophet Mohammed (PBUH) (Basic Law of Governance, 1992). In addition, the three fundamental powers, legislative, executive and judicial are vested in the King (Falgi, 2009). Furthermore, according to Article 8 of the Basic Law of Governance "Governance in the Kingdom of Saudi Arabia shall be based on justice, shura (consultation), and the equity in accordance with the Islamic Shari'ah" (Basic Law of Governance, 1992, Article 8).

5.4 THE LEGAL SYSTEM IN SAUDI ARABIA

The official religion of Saudi Arabia is Islam, and all aspects of individual life in the Kingdom are heavily influenced by Islamic law and regulations (Alkhtani, 2010; Albarrak, 2011). The Basic Law of Governance states that

> The Kingdom of Saudi Arabia is a fully sovereign Arab Islamic State. Its religion shall be Islam and its constitution shall be the book of God and Sunnah (Traditions) of His Messenger, may God's blessing and peace be upon him (PBUH). Its language shall be Arabic and its capital shall be the city of Riyadh (1992, Article 1).

According to Basheikh (2002), Islam is the basis of the legal system in Saudi Arabia. He highlights four Islamic sources:

1- The Quran is the first and primary source of the legal system in Saudi Arabia. It contains all the fundamental instructions and directives from Allah.
2- The Sunnah is the second primary source of the legal system in the Kingdom. Sunnah contains the sayings and deeds of the prophet Mohammed (PBUH) and the interpretations of the Holy Quran.
3- *Ijma'* is a secondary source which is defined as consensus by agreement among religious scholars.
4- *Qiyas* is also a secondary and is defined as the analogy and the application of the Quran and Sunnah to solve new issues and problems.

Islamic principles have a strong effect on the business environment with a focus on high ethical standards, strong protection of human rights and a strong belief in Allah (God). For this reason, Saudi Arabia adopts accounting and auditing standards and regulations that are influenced by Islamic law and principles (Al-harkan, 2005). Furthermore, the Saudi Arabian Corporate Governance Regulations are also consistent with Islamic Law (Alghamdi, 2012). For example, the main objective of corporate governance is to protect the interests of minority shareholders, because Islamic law requires fairness and equitability between all shareholders and stakeholders.

5.5 THE ECONOMIC SYSTEM IN SAUDI ARABIA

The Kingdom of Saudi Arabia is a developing country. According to Basheikh (2002) the establishment of the oil industry in 1960 led to high economic growth rates. Saudi Arabia holds the biggest oil reserves in the world, approximately 23% of global reserves in 2011 (OPEC, 2013). The economy in Saudi Arabia is heavily dependent on oil revenues which are the main source of the national income (90-95% of the total national income and 35-40% of GDP) (Falgi, 2009). In addition, it is the principal source of income for the government. The oil industry in Saudi Arabia is of two types: the exports of crude oil and also, oil refining and the export of petroleum-based products (Alkhtani, 2010). The oil wealth gives the country strong financial leverage resulting in a leading political role in the region (Albarrak, 2011), as well as membership of the politically important G20 group of countries.

Prior to the discovery of oil the Kingdom had a low level of subsistence and was one of the poorest countries in the world (Falgi, 2009; Alshehri, 2012). After 1970, when oil revenues increased dramatically, the Saudi government built a framework of five-year socio-economic development plans (Basheikh, 2002; Falgi, 2009; Alshehri, 2012). The focus of these plans was developing the levels of education and healthcare and improving the infrastructure of the country (Falgi, 2009).

In order to improve economic growth, the government created the Saudi Arabian General Investment Authority (SAGIA) in 2000 with the remit to boost investment in Saudi Arabia, which aims to improve the investment and eliminate the obstacles local and foreign investors (Alshehri, 2012). This step was followed on 3 June 2002, when the Supreme Economic Council approved a strategy of privatization, which includes telecommunications, postal services, airlines, electricity sector, railways, seaports, the water sector, sport clubs and educational services (Ministry of Economic and Planning, 2012 d; Alshehri, 2012). At the same time, the Council agreed to the establishment of a joint-stock holding company (Tadawul), jointly owned by the government and private sector, to enhance and improve the

Saudi Capital Market (Tadawul, 2012). The objectives of privatization are to increase the contribution of the private sector, reduce the economic dependence on oil and enhance the level of private investment (Ministry of Economy and Planning, 2012 c). According to Saudi Arabian General Investment Authority (2012), Saudi Arabia is the perfect investment opportunity in the top 10 most competitive economies in the world, because:

1- In terms of fiscal freedom, Saudi Arabia is ranked 5th in the world
2- It has the 10th most rewarding tax system.
3- Saudi Arabia is ranked 20th out of the 25 largest economies
4- It is the largest free market in the Middle East and North Africa (MENA) region.
5- Saudi Arabia has the ability to reform its business climate rapidly.
6- Saudi Arabia is ranked first for ease of property registration property in the MENA.
7- It is the largest recipient of the Foreign Direct Investment in the Arab World.
8- Saudi Arabia represents 25 % of the total Arab GDP.

In terms of the external environment, Saudi Arabia became the 149th member of the World Trade Organization (WTO) on 11 December 2005 (Ministry of Commerce and Industry, 2006 b). Also, it is ranked as the 12th largest exporter and 22nd largest importer of goods globally (Ministry of Commerce and Industry, 2012 a). In the service sector, Saudi Arabia is ranked as the 21st largest services importer and 33rd largest services exporter globally (Ministry of Commerce and Industry, 2012 a).

Table 5-2 Five-Year Development Plans

Plan	Period	Revenues (SAR bn)			Expenditure (SAR bn)
		Oil	Others	Total	
1st Development Plan	1970-74	163.8	12.5	176.2	75.5
2nd Development Plan	1975- 79	663.1	79.6	712.7	684.4
3rd Development Plan	1980- 84	1100.4	239.8	1340.2	1212.7
4th Development Plan	1985- 89	322.6	190.5	513.1	779.3
5th Development Plan	1990- 94	576.6	180.2	756.7	1020.5
6th Development Plan	1995- 99	586.1	234.0	820.1	967.2
7th Development Plan	2000-04	795.4	196.8	992.2	981.0

8th Development Plan	2005-09	3089.0	402.6	3491.6	2322.5
9th Development Plan	2010- 14	On- going			

Adopted: Ministry of Economy and Planning (2012 f); Alshehri (2012)

5.6 THE SUPERVISION AND MONITORING BODIES IN SAUDI ARABIA

5.6.1 THE COUNCIL OF MINISTERS

The King is charged with running the country in accordance with the dictates of Islam and supervising the implementation of *Shari'ah* (Islamic law) in the Kingdom (Basic Law of Governance, 1992). The King is the head of the Council of Ministers (effectively the equivalent of the cabinet), which is responsible for internal and external affairs, and also, for organizing governmental bodies (Basic Law of Governance, 1992). The main purpose of the Council of Ministers is to help and assist the King in his duties (Alkhtani, 2010).

5.6.2 THE CONSULTATIVE COUNCIL (*MAJLIS ASH-SHURA*)

The Consultative Council (*Majlis Ash-Shura*) was established by Royal Decree No. A/91 in March 1992 (Majlis Ash-Shura, 2011). According to the Shura Council Law the "Shura Council shall hold fast to the bond of Allah and adhere to the source of Islamic legislation. All members of the Council shall strive to serve the public interest, and preserve the unity of the community, the entity of the State, and the nation's interests" (1992, article 2). The Shura Council consists of a Chairman and 150 members. They are chosen by the King from among scholars, experts, and specialists (Shura Council Law, 1992). Members should be of the Saudi nation by descent and upbringing; well known for uprightness and competence; and not less than 30 years of age (Shura Council Law, 1992).

According to Shura Council Law (1992), the following are some of its responsibilities:

- Express opinions about the state's general policies and those that are referred by the Prime Ministers.
- Discuss and give opinions about the general economic plans and social development.
- Revise laws, regulations, and international treaties and agreements, and provide opinions and suggestions on these to the Council of Ministers.
- Discuss annual reports of government agencies and provide suggestions related to these reports.

5.6.3 THE MINISTRY OF COMMERCE AND INDUSTRY

The Ministry of Commerce and Industry (MOCI) has an important role in the Saudi Arabian economy (Falgi, 2009). The main roles of the MOCI are to develop and expand domestic and foreign trade, and to manage companies and business in the country (Ministry of Commerce and Industry, 2006). In addition, the MOCI approves the establishment of joint stock companies (Falgi, 2009). Moreover, it has an indirect supervisory role over many monitoring bodies in Saudi Arabia, such as the Saudi Capital Market Authority, the Saudi Stock Exchange, and the Saudi Organization for Certified Public Accountants (Alghamdi, 2012).

In the country's seventh five-year development plan, the ministry has a number of objectives including (Ministry of Commerce and Industry, 2012 b) :

1- Developing internal and external non-oil trade.
2- Increasing the effectiveness of the role of the private sector and encourage it to improve economic efficiency.
3- Developing the employment of nationals in the private sector.
4- Improving the performance of the trade sector in order to meet the demand for goods and services in the local markets.
5- Supporting the development of non-oil exports.
6- Developing the business services sector.

The MOCI provides certain services as follows (Ministry of Commerce and Industry, 2006 c):

1- Registering commercial activities.
2- Approving the establishment of joint stock companies.
3- Registering and protecting trade names and trademarks.
4- Resolving any issues and differences between businesses.

In addition, there are two important ministries which assist the MOCI; the Ministry of Finance, and the Ministry of Economy and Planning. All three ministries work together to enhance, develop and improve the economic environment. The Ministry of Finance prepares the government's budget and provides the funding for other government agencies (including the MOCI) to establish their projects (Ministry of Finance, 2012). The Ministry of Economy and Planning also plays a vital role in preparing the five-year plans and providing assistance to other government agencies, including the MOCI through economic studies.

5.6.4 THE MINISTRY OF ECONOMY AND PLANNING

The Ministry of Economy and Planning is one of the most important ministries with a vital role in enhancing development. This ministry has responsibility for preparing the five-year development plans (Ministry of Economy and Planning, 2012 d). The objectives of the Ministry of Economy and Planning are (Ministry of Economy and Planning, 2012 d):

1- Preparing the development plans of the Kingdom.
2- Preparing periodic economic reports with full analysis and explanation of the Saudi economy.
3- Estimating the amount needed to implement the development plans for agreement by the Council of Ministers.
4- Providing other ministries and government agencies with assistance and solving issues related with planning.
5- Conducting specialist economic studies which provide important recommendations.

5.6.5 THE MINISTRY OF FINANCE

The Ministry of Finance has evolved over time. The first stage started in 1927 when it was in the form of General Directorate of Finance which was responsible for financial matters in the Kingdom of Hejaz (the name of the state before the Kingdom of Saudi Arabia). The second stage commenced in 1932 when its name was changed to the Ministry of Finance to become the second ministry established after the Ministry of Foreign Affairs (Ministry of Finance, 2012). The third stage was initiated in 1936 when a number of general directorates were established under the control of the Ministry of Finance, including the Petroleum and Minerals Directorate, the Public Works Directorate and the Customs Directorate (Ministry of Finance, 2012). Further directorates were added in later years such as the Agricultural Directorate in 1948 (Ministry of Finance, 2012). The fourth stage started in 1954 with the merging of the Ministry of Finance and the Ministry of Economy to become the Ministry of Finance and National Economy (Ministry of Finance, 2012). The final stage to date occurred in 2003 with the separation for the responsibility for economic activities which were added to the Ministry of Planning which then became the Ministry of Economy and Planning, with the Ministry of Finance reverting to its former name (Ministry of Finance, 2013).

The main duties of the Ministry of Finance are (Ministry of Finance, 2012):

1. Supervising and monitoring the implementation of the government's fiscal and the monetary policies.
2. Preparing the government's budget.
3. Controlling the accounts between the Ministry of Finance and others ministries and government agencies.
4. Supervising the revenue of the government.
5. Supervising the annual closing accounts of the government.

5.6.6 SAUDI ARABIAN MONETARY AGENCY

The Saudi Arabian Monetary Agency (SAMA), the central bank, was established on 20 April 1952 (Saudi Arabian Monetary Agency, 2013). SAMA was the government body which had responsibility for regulating and monitoring the capital market activities until the Capital Market Authority (CMA) was established in July 2003 (Tadawul, 2012).

The main roles of the SAMA are as follows (Saudi Arabian Monetary Agency, 2013):

1. Issuing the national currency, which is the Saudi Arabian Riyal (SAR).
2. Acting as the banker to the Saudi government.
3. Supervising all commercial banks in the Kingdom of Saudi Arabia.
4. Managing the Kingdom's foreign exchange reserves.
5. Conducting monetary policy in order to promote price and exchange rate stability.
6. Promoting economic growth.
7. Ensuring the soundness of the financial system.

5.7 THE REGULATION OF COMPANIES IN SAUDI ARABIA

5.7.1 THE COMPANIES ACT (1965)

The Companies Act was issued in its first version on 20 July 1965 (Basheikh, 2002) to regulate the operations of Saudi companies (Alghamdi, 2012). The first version was derived from the British Companies Act (Alghamdi, 2012). The main function of the Companies Act is to regulate the transactions of commercial companies, such as joint stock companies, particular partnership, liability companies, limited liability companies, and also, foreign companies (Alshehri, 2012). The Companies Act has been amended four times in 1967, 1982, 1985 and 1992 (Basheikh, 2002). Furthermore, a new version is expected shortly (Alshehri, 2012).

5.7.2 THE INCOME TAX AND ZAKAT LAW

Zakat is a religious tax levied at the end of every financial year at the rate of 2.5% of the total monetary values of an individual's assets (Basheikh, 2002; Alkhtani, 2010). The *Zakat* law was issued by Royal Decree No. 17/2/28/8634 in 1951, which has been amended twice in 1951 and 1956 (Department of Zakat and Income Tax, 2012 a). According to Article No. 1 "Zakat duty shall be collected in full in accordance with provisions of Islamic Law (Shariah) from all Saudi person, shareholders of Saudi companies whose all shareholders are Saudi, and Saudi shareholders of joint companies whose shareholders are Saudi and non-Saudi" (Department of Zakat and Income Tax, 2012 a). Article 6 of the *Zakat* law states that all individuals and companies must keep organized books that shows the capital, revenue and expenses accounts for each year in order to calculate the amount of *Zakat* (Department of Zakat and Income Tax, 2012 b).

The regulation of Income Tax first started with issuance of Royal Decree No. 17/2/28/3321 dated 2 November 1950. It has been amended several times in 1951, 1956 and 1986 (Basheikh, 2002; Department of Zakat and Income Tax, 2012 a) and last amended was in 2004 (Ministry of Foreign Affairs, 2012). According to Article 2 of the Income Tax law, the individuals subject to pay income tax are (Department of Zakat and Income Tax, 2012 c):

1- A resident capital company with respect to the share of a non-Saudi partner.
2- A resident non-Saudi person who conducts business in Saudi Arabia.
3- A non-resident who conducts business in Saudi Arabia through a permanent establishment.
4- A person engaged in the natural gas and hydrocarbons investment field.

5.7.3 THE SAUDI ACCOUNTING ASSOCIATION

In 1979, Yousef Al-Hamdan, the Deputy Minister of Commerce, and Abdulaziz Al-Rashed, the head of the Al-Rashed firm, entered into discussions as how to develop an accounting and auditing professional environment in Saudi Arabia (SOCPA, 2011). At the end of 1981, the Scientific Board of the King Saud University agreed to establish the Saudi Accounting Association (SAA) as a non-profit society supervised by King Saud University (Saudi

Accounting Association, 2012). The main objectives of the Saudi Accounting Association are (Saudi Accounting Association, 2012; Alkhtani, 2010):

1. Developing the accounting concepts in Saudi Arabia.
2. Providing advice and studies to other institutions and companies in the accounting field.
3. Producing and supervising accounting research.
4. Running conferences and seminars to discuss the issues related to the accounting field.

5.7.4 THE ORGNIZATION FOR CERTIFIED PUBLIC ACCOUNTANTS

The Saudi Organization for Certified Public Accountants (SOCPA) was established by Royal Decree No. M/12, in 1992, as a professional organization (SOCPA, 2013). It is operated by a board of directors under the supervision of the MOCI (SOCPA, 2013). The board contains thirteen members, with the Minister of Commerce and Industry as the Chairman (Alkhtani, 2010). The main activities of this organization are (SOCPA, 2013):

1. Reviewing, developing, and approving accounting and auditing standards.
2. Setting and supervising the rules for the fellowship certificate examinations.
3. Organizing courses for accounting and auditing topics in order to solve new issues and problems.
4. Promoting research work in the accounting and auditing fields.
5. Publishing books covering accounting and auditing topics.
6. Establishing a specific program in order to ensure that certified public accountants comply with accounting and auditing standards.
7. Participating in local and international conferences and committees in the accounting and auditing fields.

It is worth noting that corporate governance is not specifically covered in any of these activities, except to the extent that external auditing may be regarded as part of a company's corporate governance mechanisms.

5.7.5 THE CAPITAL MARKET AUTHORITY

The Capital Market Authority (CMA) in Saudi Arabia started unofficially in the early 1950s (Capital Market Authority, 2012). The official CMA was established by Royal Decree in 2004 as an independent government organization with full financial, legal, and administrative independence. It reports directly to the Prime Minister (Falgi, 2009; Alkhtani, 2010; Capital Market Authority, 2012). The main objective of the CMA is to regulate and develop the Saudi Arabian Capital Market (Capital Market Authority, 2012), including establishing regulations, rules and instructions which related to Saudi Stock Exchange (Alshehri, 2012). To achieve this objective the CMA is entrusted with the following duties (Capital Market Authority, 2012):

1. To issue the rules and regulations for implementing the provisions of the Capital Market Law.
2. To protect investors from unfair and unsound practices such as fraud, cheating, deceit, manipulation and insider trading.
3. To provide and maintain fairness, and achieve efficiency and transparency in equity transactions.
4. To take measures to reduce risks pertaining to the transactions of securities.
5. To develop, regulate and monitor the issuance of equities.
6. To regulate and monitor the activities of entities that work under the CMA control.
7. To regulate and monitor full disclosure of information related to securities and issuers.

The CMA is governed by a board of five members, who should be Saudi nationals and appointed by Royal Decree (Capital Market Authority, 2012). One of the most important regulations is corporate regulations which issued by the board of the CMA in 2006 as a recommended regulation that became compulsory in 2010 (Alghamdi, 2012).

5.8 THE SAUDI STOCK MARKET

5.8.1 HISTORICAL BACKGROUND

In 1934, the Arabian Automobiles Company became the first joint stock company to be established in Saudi Arabia (Basheikh, 2002; Alkhtani, 2010). During the 1950s, the number of joint stock companies increased by four with a total paid-up capital of SR943m divided into 9.3 million shares, with the establishment of three electricity companies and the Arab Cement Company (Basheikh, 2002; Al-harkan, 2005). The number of companies increased rapidly during the economic boom of the 1970s, when 17 companies mainly concentrated in the cement, electricity and banking sectors were set up (Basheikh, 2002; Alkhtani, 2010).

As a result of the Souk Al-Manakh crisis in Kuwait, in 1984 the Saudi Arabian government was called upon to establish a committee responsible for regulating and developing the stock market in Saudi Arabia (Al-harkan, 2005). This committee consisted of representatives from the Ministry of Finance and National Economy, the Ministry of Commerce and SAMA (Basheikh, 2002; Al-harkan, 2005). This committee delegated the responsibility of the capital market to SAMA (Basheikh, 2002). To achieve this role SAMA established a specific department called the Stock Control Department, which is responsible and oversees the daily stock transactions (Basheikh, 2002; Al-harkan, 2005). By 1985, the number of companies listed on the stock exchange reached 57 with a total share capital of SR52bn (Basheikh, 2002).

5.8.2 THE NEW SAUDI STOCK MARKET (TADAWUL)

In July 2003, SAMA delegated the responsibility for the Saudi stock market operations to the CMA (Tadawul, 2012). In March 2007, the Council of Ministers agreed to establish the Saudi Stock Exchange (Tadawul) (Tadawul, 2012) as a joint stock company to look after the day-to-day operations of the Tadawul (Alshehri, 2012). According to Piesse et al. (2012), the features of the Saudi stock market are that it is one of the largest, has one of the highest annual turnovers, is one of the most active and has one of the highest capitalizations in MENA.

The number of share traded increased from 2.77 billion in 2000 to 68.515 billion in 2006 and by 2005 the capitalization reached a peak of SR2,438.2bn (approximately US$651bn) with the share price index hitting 16,712.2. At the beginning of 2006 the Tadawul crashed (Alkhtani, 2010), with capitalization falling by almost half to SR1,225.9bn (approximately US$327bn). Because of the crash, the CMA formulated new regulations and requirements for corporate governance codes with higher levels of disclosure and compliance (Alkhtani, 2010). However, by 2012, the Saudi Arabia stock market was the 27th largest in the world by total market capitalization USD373.375bn, the 15th largest in the emerging economies, and the largest Arabic market in MENA (World Federation of Exchanges, 2013). The table below shows the Saudi capital market performance for the period 2000 to 2011

Table 5-3 The Saudi capital market performance for the period 2000-2011

Year	NO. of share traded (Million)	Value of share traded (Billion SR)	Market capitalization of issued shares (Billion SR)	Number of transaction (Thousand)	Share price index
2000	2774.6	65.3	254.5	498.1	2258.3
2001	3459.2	83.6	274.5	605	2430.1
2002	8679.2	133.8	280.7	1033.7	2518.1
2003	27829.3	596.5	589.9	3763.4	4437.6
2004	51491.7	1773.9	1148.6	13319.5	8206.2
2005	61406.7	4138.7	2438.2	46608	16712.6
2006	68515.3	5261.9	1225.9	96095.9	7933.3
2007	57829	2557.7	1946.4	65665.5	11038.7
2008	58726	1962.9	924.5	52135.9	4803
2009	56685	1264	1195.5	36458.3	6121.8
2010	33255	759.2	1325.4	19536.1	6620.8
2011	48545	1098.8	1270.8	25546.9	6417.7

Source: Saudi Arabian Monetary Agency (2013)

Table 5-4 World's largest stock markets by total market capitalization for 2012

Rank of emerging market	Rank of all countries	Market	Market CAP. (Million US $)
	1	NYSE Euronext (US)	14085944
	2	NASDAQ OMX	4582389
	3	Japan Exchange Group - Tokyo	3478832
	4	London SE Group	3396505
	5	NYSE Euronext (Europe)	2832189
1	6	Hong Kong Exchanges	2831946
2	7	Shanghai SE	2547204
	8	TMX Group	2058839
	9	Deutsche	1486315
	10	Australian SE	1386874
3	11	BSE India	1263336
4	12	National Stock Exchange India	1234492
	13	SIX Swiss Exchange	1233439
5	14	BM&FBOVESPA	1227447
6	15	Korea Exchange	1179419
7	16	Shenzhen SE	1150172
	17	NASDAQ OMX Nordic Exchange	995719.2
	18	BME Spanish Exchanges	995088.5
	19	Johannesburg SE	907723.2
8	20	MICEX / RTS	825340.5
9	21	Singapore Exchange	765078
10	22	Taiwan SE Corp.	735292.6
11	23	Mexican Exchange	525056.7
12	24	Bursa Malaysia	466587.6
13	25	Indonesia SE	428222.6
14	26	The Stock Exchange of Thailand	389756.3
15	**27**	**Saudi Stock Exchange - Tadawul**	**373374.8**
	28	IMKB	315197.5
	29	Santiago SE	313325.3

Source: World Federation of Exchanges (2013)

According to Tadawul (2013), it has two main objectives, with a number of sub-objectives:

1. Operating the market efficiently and delivering excellent service:

  - Operating the market effectively and efficiently.
  - Ensuring market integrity, quality, and fairness.

- Supporting investors’ education by holding seminars.
- Developing service excellence for customers and other stakeholders.
- Developing the exchange's capabilities and competencies.

2. Developing a leading financial exchange by supporting competitive investment and financing channels:

- Supporting efficient capital-raising for companies.
- Providing innovative, diversified, and integrated financial market products, services, and investment.
- Attracting national and international market participants.
- Integrating and leveraging offerings across the value chain.
- Providing superior financial returns and shareholder value.

The table below shows the market performance of Arab countries for the period 1 Jan 2013 to 2 Jul 2013

Table 5-5 The market performance of Arab countries for the period 1 Jan 2013 to 2 Jul 2013

Market	Value Traded (Million US $)	Shares Traded (Million)	Market Capitalization (Million US $)	NO. of Contracts	Turnover (%)
ABU DHABI SECURITIES MARKET	9,703.4931	23,039.0646	101,678.19	252463	9.5433
AMMAN STOCK EXCHANGE	2,903.9845	1,739.7447	25,672.66	640593	11.3116
BAHRAIN STOCK EXCHANGE	359.3026	1,213.425	17,356.38	7582	2.0701
BEIRUT STOCK EXCHANGE	131.8692	17.7483	16,593.43	5496	0.7947
CASABLANCA STOCK EXCHANGE	3,578.6580	92.4027	49,605.52	61988	7.2142
DAMASCUS SECURITIES EXCHANGE	15.1069	10.3832	1,553.44	5558	0.9725
DOHA SECURITIES MARKET	9,217.1051	828.6349	148,112.57	418402	6.2230
DUBAI FINANCIAL MARKET	16,222.5882	45,416.5913	58,953.35	553030	27.5177
EGYPT CAPITAL MARKET	8,220.5922	11,240.9134	49,006.52	2056921	16.7745
KUWAIT STOCK MARKET	0.0000	0	102,653.61	0	0.0000
MUSCAT SECURITIES MARKET	2,934.3798	4,541.2752	25,234.11	245065	11.6286
PALESTINE SECURITIES EXCHANGE	132.5954	73.6482	2,762.46	20257	4.7999
SAUDI STOCK MARKET	**204,125.0706**	**29,014.071**	**404,774.76**	**4733639**	**50.4293**
TUNIS STOCK EXCHANGE	469.5387	110.5056	9,076.48	298195	5.1731
Total	**258,014.2843**	**117,338.4081**	**1,013,033.48**	**9299189**	**25.4695**

Source: Arab Monetary Fund (2013)

5.9 CORPORATE GOVERNANCE IN SAUDI ARABIA

5.9.1 BACKGROUND TO THE SAUDI ARABIAN COROPORATE GOVERNANCE CODES

Until 2006, there were no specific corporate governance regulations. As the CMA was only established in 2003, the gap between its setting up and the issuance of corporate governance regulations was only three years. In February 2006, the Saudi stock market suffered a huge crash (Alshehri, 2012), which provoked the CMA to approve new regulations for corporate governance in order to help protect shareholders and other stakeholders.

Figure 5-2 Saudi General Stock Market Index, 2006

Source: reproduced from (Alshehri, 2006) (as cited in Alshehri, 2012)

On 12 November 2006, the board of the CMA issued the regulations of corporate governance for the Kingdom of Saudi Arabia (Corporate Governance Regulations in the Kingdom of Saudi Arabia, 2006). The codes are strongly influenced by the 2004 OECD principles, with most articles based on or similar to the OECD code (Alshehri, 2012). The Codes adopt a 'comply or explain' policy which requires companies to disclose in the board's report provisions that have been implemented and those not implemented and explain the reasons for non-compliance (Falgi, 2009; Alshehri, 2012).

Since 2006, some elements of the Saudi Arabian corporate governance codes have been revised, while a number of articles have become mandatory (Alshehri, 2012). For example, in November 2008, Article 9 which relates to disclosure in the board of directors' report became mandatory for all companies listed on the Saudi Arabian stock market. These companies now have to report certain provisions; for example, classify the board of director types into executive and non-executive, name any joint stock companies to which the member of the board also acts as a member of its board, detail the remuneration paid to board members, and report any punishment imposed on the company by the CMA. Moreover, on the same date a number of elements of Article 12, which is related to the majority of the board of directors, became mandatory.

On 10 November 2008, Article 14, which is related to the appointment, duties and responsibilities of the audit committee, also became mandatory. In addition, Article 15, which discusses the nomination and remuneration committee, was slated to become mandatory from March 2010. Lastly, elements of Articles 5, 10 and 12 were to become mandatory from 30 December 2012. These related to shareholders' rights, the function and formation of the board of directors.

The Saudi Arabian corporate governance regulations, which comprise five sections with a total of 19 articles, regulate and operate the listed companies in the Saudi stock market. These regulations deal with the right of shareholders, disclosure and transparency, and the board of directors. Also, in Article 2 the regulations defines key terms such as independent member, non-executive director, first-degree related, shareholders, accumulative voting and minority shareholders in order to ensure the code is understood and applied correctly.

5.9.2 COMPANY STRUCTURE

According to the Companies Act 1965, Article 66 stipulates that each company is directed by a board of directors with at least three members, who are appointed at Annual General Assembly for a period of not more than three years. The board of directors of Saudi Arabian companies contains of two types of members, executive and non-executives, in a one-tier board that takes the form of unitary board, following the Anglo-Saxon model (Mallin, 2007;

Solomon, 2007). Article 68 stipulates that to be a member of board of director must own 1000 shares in the company with a market value of not less than SR10,000. Also, the Companies Act permits a board member to be a member of boards in other companies without limit (Falgi, 2009).

5.9.3 SHAREHOLDERS RIGHTS

The Companies Act endorses and protects shareholders' rights in a number of articles. The general rights of the shareholders include the right to share in the distribution of profits, attend the general assembly and participate in its deliberations. Thus, Article 78 gives all shareholders the right to claim against for any member of the board of directors for any wrong or mistaken actions, while Article 83 stipulates that each shareholder who holds 20 or more shares has the right to attend the company's general assemblies. Furthermore, each shareholder has the right to discuss the topics of the assembly and ask questions to any member of the board of directors or external auditor (Article 94, Companies Act 1965). Moreover, Article 109 stipulates that shareholders who own 5% or more of the capital have the right to request from the Dispute Resolution Authority an inspection of the company if they find any reason or doubt about the behaviour of the board of directors or external auditors.

Furthermore, the Corporate Governance Regulations of Saudi Arabia (2006) contains five articles which relate to shareholders' rights. The first article is concerned with the general rights of shareholders such as attending the general assembly, access to the distribution of profits and the right to supervise the board members. The second article is related to access to available information which should be comprehensive, accurate and updated. The third article discusses on the general assembly including the announcing of the date, place and agenda at least 20 days prior the date of meeting. It also highlights the rights to discuss any topic on the agenda and ask questions to the board of directors and auditors. The fourth article focuses on voting rights which include the right to vote in the general assembly for the nomination to the board members. In addition, the shareholder is given the right to appoint in writing any other shareholder who is not a board of member and who is not an employee of the company to attend the general assembly on his/her behalf. The fifth article which is related to the right to dividends includes the right to be informed of policy regarding dividends, of the date and of the amount of the distribution.

5.9.4 THE BOARD OF DIRECTORS

The Companies Act of Saudi Arabia discusses the board of directors in a number of articles which set out their main duties and responsibilities, how board members are appointed and stipulate the regulations and rules that are related to the work and mechanisms of the board members. The main objectives of the boards of directors are to protect and secure the investment of shareholders and the interests of other stakeholders (Al-harkan, 2005). The board of directors in Saudi Arabian companies is similar in structure to Anglo-American companies (a one-tier board) (Piesse et al., 2012). According to Piesse et al., the average size of the board of directors in Saudi Arabia is 8.6 members. Also, Falgi (2009) suggests that the board size should be related to the company size. His research indicates that small companies should have a board of directors containing between four and eight members, medium-size companies should have six to ten members, and large companies should have seven to 12 members (the company size depends on the total assets and the capital structure) (Falgi, 2009).

Section four of the Saudi Arabian Regulation of Corporate Governance discusses the board of directors. Article 10 sets out the main functions of the board of directors as:

- Approving strategies, plans, and objectives of the company.
- Creating and developing an internal control system for the company to ensure the integrity of the accounting procedures related to the preparation of the financial reports.
- Creating a policy that regulates the relationship with stakeholders and states how to protect their rights.
- Creating the policies and standards for the membership of the board of directors and implementing them after they have been approved by the general assembly.

The Regulations stipulates that the number of the board members should not be less than three and not more than eleven depending on the company size. The majority of the board must be non-executive members (Corporate Governance Regulations in the Kingdom of Saudi Arabia, 2006). The Corporate Governance Regulations recommend the separation of the position of the Chairman of the Board and the Chief Executive Officer (CEO), and that the Chairman must be a non-executive member. Moreover, the independent members should not be less than two members, or one-third of the total directors (Corporate Governance Regulations in the Kingdom of Saudi Arabia, 2006).

In addition, the Saudi Corporate Governance Regulations (2006) recommend the establishment of a suitable number of sub-committees in order to enable the board to perform its duties in an effective manner. There are three sub-committees that require to be set up in the companies listed on the Saudi stock market: the audit committee; the nomination and remuneration committee; and the executive committee. Previously, the audit committee was the only sub-committee that existed in Saudi companies (Al-Moataz, 2003). According to Falgi (2009) in 2003 SOCPA created a committee to evaluate the performance of audit committees in the listed companies, which made the following conclusions (SOCPA, 2007 cited in Falgi, 2009):

- There is a lack of clarity concerning the tasks and field of action of audit committees.
- Some board members and committee members are unaware and misunderstand the purpose of the audit committee.
- The concept of independent members of the audit committee is not well known.
- The professional and academic qualifications of some committee members are inadequate.
- There is a lack of a control system to monitor audit committee practices.

After these conclusions, the committee established a project in order to improve the performance of the audit committees (Falgi, 2009). According to Article 14 of the Saudi Corporate Governance Regulations (2006) there should be no less than three non-executive members on the audit board committees with good financial and accountancy backgrounds. According to the Regulations the main functions and responsibilities of the audit committees are:

1. To independently supervise the company's internal audit in order to ensure the company's effectiveness in executing the activities and duties specified by the board of directors.
2. To review the internal audit procedures, review the internal audit reports for errors and provide recommendations.
3. To supervise the activities of the external auditors.
4. To review with the external auditors the audit plan.

5. To review the external auditor's comments on the financial statement.
6. To review the interim and annual financial statements prior to presentation to the board of directors and give advice and opinions.
7. To review the accountancy policies and providing any advice or recommendations in relation to them.

The nomination and remuneration committees recommended by the Corporate Governance Regulations are responsible for issuing rules in relation to the appointment of members of the board of directors, to review annually the skills required for membership of the board; and set out clear policies regarding the remuneration of board members and top executives (Corporate Governance Regulations in the Kingdom of Saudi Arabia, 2006).

5.9.5 THE COMPANY'S INTERNAL CONTROL SYSTEM

In 2001 a ministerial committee was established to study the situation of the Saudi listed companies. The Higher Economic Council approved the recommendations of the committee in relation to the internal control system in the listed companies in the Saudi stock market (Falgi, 2009). The recommendations were: (Ministry of Commerce and Industry, 2012, cited in Alshehri, 2012):

1. To strengthen the important role of internal control in the listed companies and to educate shareholders about their role in monitoring companies' performances.
2. To ensure that adequate information appears in the company financial statements in order to enable investors to assess company performance in order to take the right decisions to protect their investments.

5.9.6 DISCLOSURE AND TRANSPARENCY

Disclosure and transparency are important practices that are integral to good corporate governance and to reducing the information asymmetries between insiders and outsiders (Piesse et al., 2012). Saudi Corporate Governance Regulations state that the company should disclose and write policies, procedures, and rules that are related to corporate governance mechanisms (Corporate Governance Regulations in the Kingdom of Saudi Arabia, 2006). The Regulations require disclosure of certain information in the board of directors' report, which is appended to the annual financial statement (Corporate Governance Regulations in the Kingdom of Saudi Arabia, 2006). This report should include the following information (Corporate Governance Regulations in the Kingdom of Saudi Arabia, 2006):

- The implemented and unimplemented provisions of these regulations, with justifications for not implementing them.
- The disclosure of the names of any board members who act as a board member of other joint stock companies.
- The classification into executive, non-executive or independent board members.
- The description of all sub-committee boards, such as audit, nomination and remuneration.
- The full details concerning compensation and remuneration paid to the Chair and other board members.
- The details of any punishment imposed on the company.
- The results of the annual audit concerning the internal control of the company.

5.10 SUMMARY

This chapter provides a brief background to the Saudi Arabian environment in terms of its economy, legal and political systems. It also provides a brief description of bodies in the Kingdom that play a significant role in improving and developing the Saudi business environment such as the Ministries of Finance, of Economy and Planning, and of Commerce and Industry and other agencies such as SAMA. In addition, it focuses on the regulation of the Saudi Arabian companies through the Companies Act, SOCPA and the CMA. Moreover, the chapter sheds light on the Corporate Governance Regulations in Saudi Arabia, specifically looking at company structure, shareholders’ rights, boards of directors, internal control, and disclosure and transparency; all of which are important elements for understanding the mechanisms of the corporate governance regulation in the Kingdom of Saudi Arabia.

The next chapter provides details on the research methodology and design in order to help achieve the research objectives.

6 RESEARCH DESIGN AND METHODOLOGY

6.1 INTRODUCTION

This chapter presents and discusses the research methodology and data collection used in this study, beginning with the definition of research, followed by the research types. The researcher then identifies the two main research paradigms and explains the quantitative and qualitative research methodologies used in this study, which resulted in a triangulation methodology. After that, the text provides details about the data collection methods and the sample that was included in the study, ending with a brief conclusion and summary.

6.2 DEFINITION OF RESEARCH

There is a debate about the term 'research', which normally refers to the way in which the data are collected (input) and the results that may be produced from these data (output) (Saunders et al., 2007). However, some scholars define 'research' as a systematic approach that contains a specific set and sequence of activities that lead to finding out useful information and to investigating the unknown in order to solve a problem (Maylor and Blackmon, 2005; Saunders et al., 2007). Sekaran (2005, p. 370) (as cited in Alshehri, 2012) defined research as "an organised, systemic, data-based, critical, scientific inquiry or investigation into a specific problem, undertaken with objective of finding answers or solutions to it". Saunders et al. (2007) highlight characteristics of aspects of research: data are collected systematically, data are interpreted systematically, and the study's clear purpose is to find things out.

Research is essential for understanding at basic phenomena in our lives, such as economic, education, and business. Also, it provides the decision-maker with a good decision and with judgement about the right solution to a particular problem, and it gives the decision-maker a good prediction about the future (Ghauri and Grønhaug, 2005). Collis and Hussey (2003) summarised the purpose of research as follows:

1. To review and synthesise existing knowledge
2. To investigate some existing situation or problem
3. To provide solutions to a problem
4. To explore and analyse more general issues
5. To develop or create a new procedure or system
6. To explain a new phenomenon
7. To contribute new knowledge

6.3 TYPES OF RESEARCH

Collis and Hussey (2003) classified types of research into four groups based on purpose, process, logic, and outcomes. The table below shows the classification of the main types of research based on various classifications.

Table 6-1 Classification of main types of research

Type of research	*Basic of classification*
Exploratory, descriptive, analytical, or predictive research	Purpose of the research
Quantitative or qualitative research	Process of the research
Deductive or inductive research	Logic of the research
Applied or basic research	Outcome of the research

Source: Collis and Hussey (2003)

First, classification is the purpose of the research, of which four types exist: exploratory, descriptive, analytical, or predictive research:

- Exploratory research is conducted in a research problem when there are very few or no earlier studies (Collis and Hussey, 2003) and also when the research problem is badly understood (Ghauri and Grønhaug, 2005). The main aim of this type of research is to look for an idea or hypothesis rather than testing or confirming a hypothesis (Hussey and Hussey, 1997). This type of research requires special skills, such as the ability to observe, get information, and construct an explanation that is theorizing (Ghauri and Grønhaug, 2005). It can be used in case studies, observation, and historical analysis, which can provide both quantitative and qualitative data (Collis and Hussey, 2003).
- Descriptive research involves describing phenomena as they exist (Collis and Hussey, 2003), and this type of research is structured and well-understood (Ghauri and Grønhaug, 2005). This type of research's main objective is to gain and to obtain accurate profile information of events, persons, or situations (Saunders et al., 2012). The data collected are often quantitative, and statistical techniques are usually used to summarise the information (Collis and Hussey, 2003).
- Analytical research is a continuation of descriptive research, with more explanation and analysing of why or how the problem happened (Collis & Hussey, 2003). The emphasis is on studying a situation or a problem in order to understand phenomena by

discovering and measuring causal relations between variables (Collis and Hussey, 2003; Saunders et al., 2012).

- Predictive research goes even further than analytical research does; it aims to make generalizations from the analysis by predicting certain phenomena on the basis of a hypothesis and a general relationship (Collis and Hussey, 2003).

The second classification is the process of the research, which is divided into two main types of research: quantitative and qualitative research. Quantitative research is objective in nature and concentrates on measuring phenomena, which involves collecting and analysing numerical data as well as applying statistical tests, whereas, qualitative research is more subjective in nature and involves examining and reflecting on perception in order to obtain and to gain more of an understanding of the situation (Collis and Hussey, 2003).

The third classification is the logic of the research, which is divided into two main types of research: deductive and inductive research. Deductive research is a study in which a conceptual and theoretical structure is developed and in which the researcher draws conclusions through logical reasons (Collis and Hussey, 2003; Ghauri and Grønhaug,, 2005). After that, the researcher tests theory via empirical observations; thus, some particular instances are deduced from general inferences, which means that the deductive method is to move from general to particular (Collis and Hussey, 2003); this type of research is more suitable with quantitative type of research (Ghauri and Grønhaug, 2005). In contrast, inductive research is a study in which theory is developed from the observation of empirical reality; thus, general inferences are induced from a particular instance, which means that the researcher draws general conclusions from an empirical observation, and this type of research is often used in qualitative research (Collis and Hussey, 2003; Ghauri and Grønhaug, 2005). The table below distinguishes between deductive and inductive research.

Table 6-2 Comparison between deductive and inductive research

	Deductive	**Inductive**
Logic	In a deductive inference, when the premises are true, the conclusion must also be true.	In an inductive inference, known premises are used to generate untested conclusion.
Generalisability	Generalising from the general to the specific	Generalising from the specific to the general
Use of data	Data collection is used to evaluate propositions or hypotheses that are related to an existing theory.	Data collection is used to explore a phenomenon, to identify themes, and patterns, and to create a conceptual framework.
Theory	Theory falsification or verification	Theory generation and building

Source: Saunders et al. (2012)

The fourth classification is the outcome of the research, which is divided into two main types of research: applied and basic research. Basic research is referred to as fundamental or pure research; however, applied research is designed to apply its findings to solving a specific problem (Collis and Hussey, 2003). The table below distinguishes between basic and applied research.

Table 6-3 Comparison between basic and applied research

	Basic research	Applied research
Purpose	• Expand knowledge of processes business and management. • Results in universal principles that relate to the process and its relationship to outcomes • Findings of significance and value to society in general	• Improve understanding of a particular business or management problem. • Results in solution to problem • New knowledge limited to problem • Findings of particular relevance and value to manager(s) in organisation(s)
Context	• Undertaken by people based at universities • Choice of topic and objectives determined by the researcher • Flexible time scales	• Undertaken by people based in a variety of settings, including organisations and universities • Objectives negotiated with originator • Tight time scales

Source: Easterby-Smith et al. (2008); Hedrick et al. (1993) (as cited in Saunders et al., 2012).

6.4 RESEARCH PARADIGM

Thomas Kuhn and his essay '*The Structure of Scientific Revolutions*' *(1962)* introduced the term 'paradigm' and gave more attention to philosophers and sociologists of science (Corbetta, 2003). Corbetta (2003) argued the importance of paradigms for the sciences and that any sciences that lack paradigms seem to lack orientation and do not have clear criteria of choice (Falgi, 2009).

Saunders et al. (2012) argued that the term 'paradigm' leads to more confusion because it tends to have multiple meanings. For example, Collis and Hussey (2003) defined paradigm as the progress of social scientific practice based on philosophers and assumptions about the world as well as the nature of knowledge and how the research should be conducted. Saunders et al. (2012) defined paradigm as a way of studying and examining social phenomena from which particular understandings of these phenomena can be obtained and explanations attempted. Bryman (1988, p. 4) stated that a paradigm is "a cluster of beliefs and dictates which for scientists in a particular discipline influence what should be studied, how research should be done, [and] how results should be interpreted".

Collis and Hussey (2003) said that the term of paradigm is used quite loosely in academic research, so it can have different means. Burrell and Morgan (1979) suggested that the term 'paradigm' can be used at three different levels (as cited in Collis & Hussey 2003):

1. The philosophical level, where it is used to reflect basic beliefs about the world
2. The social level, where it is used to provide guidelines about how the researcher should conduct his or her endeavours
3. The technical level, where it is used to specify the methods and techniques which ideally should be adopted when conducting research

According to Burrell and Morgan (1982) (as cited in Saunders et al., 2012), the purpose of a paradigm is as follows:

- to help researchers to clarify their assumptions about their views of the nature of science and society;
- to provide a useful way of understanding the way in which other researchers approach their work;
- to help researchers to plot their own routes through their research, and to understand where it is possible to go and where they are going.

Collis and Hussey (2003) classified a research paradigm into two main philosophies: positivist and interpretivist. The table below presents some of the more common terms used to describe both paradigms.

Table 6-4 The common terms for both two main paradigms

Positivistic paradigm	***Interpretivist paradigm***
Quantitative	Qualitative
Objectivist	Subjectivist
Scientific	Humanistic
Experimentalist	Interpretivist
Traditionalist	

Source: Collis and Hussey (2003)

The table below presents a number of different methodologies associated with two main paradigms that are used in the management and business research.

Table 6-5 The methodologies associated with two main paradigms

Positivistic paradigm	***Interpretivist paradigm***
Cross-sectional studies	Action research
Experimental studies	Case studies
Longitudinal studies	Ethnography
Surveys	Feminist perspective
	Ground theory
	Hermeneutics
	Participative enquiry

Source: Collis and Hussey (2003)

6.4.1 THE POSITIVISTIC PARADIGM

Alshehri (2012) described the positivist paradigm as an umbrella term for research using the quantitative methodology. This approach emerged in the 19^{th} century by French philosopher Auguste Comte (1789–1857) (Benton and Craib, 2001; Hughes and Sharrock, 1997). The positivistic paradigm in social science is based on the approach used in the natural sciences, such as biology and physics, and the end of the 19^{th} century, social science adopted this approach (Collis and Hussey, 2003). Bryman and Bell (2003, p. 14) defined positivism as "an epistemology position that advocates the application of the methods of natural sciences to the study of social reality and beyond. But the tem stretches beyond this principle, though the constituent elements vary between authors".

Bryman and Bell (2003) outlined some principles that positivism entails:

1. Principle of phenomenalism: Only phenomena and hence knowledge confirmed by the senses can genuinely be warranted as knowledge.
2. Principle of deductivism: The purpose of theory is to generate hypotheses that can be tested and that will thereby allow explanations of laws to be assessed.
3. Principle of inductivism: Knowledge is arrived at through the gathering of facts that provide the basis for laws.
4. Science must be conducted in a way that is value-free.
5. There is a clear distinction between scientific statements and normative statements, and a belief exists that the former is a true domain of the scientist.

The positivistic approach involves trying to seek the facts or causes of the social problem and phenomena, with little regard to the subjective state of the individual (Collis and Hussey, 2003). It is founded on the belief that the study of human behaviour should be conducted in the same way that studies are conducted in the natural sciences, and it should be concerned with the examination of social science's observable reality, in which the final product can be law-like generalizations, such as those produced by scientists (Collis and Hussey, 2003; Gill and Johnson, 2010; Saunders et al., 2012; Alshehri, 2012).

Collis and Hussey (2003) outlined the main features of the positivistic paradigm:

- Tends to produce quantitative data;
- Uses large samples;
- Concentrated with hypothesis testing;
- Data are highly specific and precise;
- The location is artificial;
- Reliability is high;
- Validity is low;
- Generalises from sample to population.

However, there are some criticisms of the positivistic paradigm (Collis & Hussey, 2003):

- It is impossible to treat people as being separate from their social contexts, and they cannot be understood without examining the perceptions they have of their activities.
- Research design is highly structured, imposes certain constraints on the results, and may ignore other related and relevant findings.

- Researchers are not objective but rather are part of what they observe.
- Capturing complex phenomena in a single measure is misleading.

6.4.2 THE INTERPRETIVIST (PHENOMENOLOGICAL) PARADAIGM

The conflict between the positivist and interpretivist paradigms can be traced back to the 19^{th} century in Germany (Hammersley, 2013). Interpretivist is a term that is opposite of positivism, which obtained its importance as a result of the failure of positivism to provide social sciences with a suitable measure for social phenomena and problems (Alshehri, 2012). The interpretivist paradigm comes from this view of philosophers: The physical and natural sciences deal with objects that are outside of us, whereas the social sciences deal with action and behaviour that are generated from within the human mind (Collis & Hussey, 2003). According to Hussey and Hussey (1997), the interpretivist paradigm is focused on the understanding of human behaviour from the participant's own frame of reference.

Burrell and Morgan (1979, p. 28) defined interpretive paradigm " is informed by a concern to understand the world as it is, to understand the fundamental nature of the social world at the level of subjective experience". Other definition that Bryman and Bell (2003, p. 16) introduced defined interpretivism as being "predicated upon the review that a strategy is required that respects the differences between people and the objects of the natural science and therefore requires the social scientist to grasp subjective meaning of social action". In addition, philosophers believe that social science's reality is dependent on the mind; no reality exists independently of the mind (Collis & Hussey, 2003).

Collis and Hussey (2003) outlined the important features of the interpretivist paradigm:

- Tends to produce qualitative data ;
- Uses small samples;
- Concerned with generating theories;
- Data are rich and subjective;
- The location is natural;
- Reliability is low;
- Validity is high;
- Generalises from one setting to another.

The table below describes the assumptions of the two main paradigms (positivistic and interpretivist):

Table 6-6 The assumptions of the two main paradigms

Assumption	*Question*	*Positivism*	*Interpretivism*
Ontological: the researcher's view of the nature of reality or being.	What is the nature of reality?	Reality is objective and singular, apart from the researcher.	Reality is subjective, socially constructed and multiple as seen by participants in a study.
Epistemological: the researcher's view regarding what constitutes acceptable knowledge	What is the relationship of the researcher to that researched?	Researcher is independent from that being researched. Only observable phenomena can provide credible data. Focus on causality and law, such as generalisation, reducing phenomena to simplest elements.	Researcher interacts with that being researched. Subjective meanings and social phenomena. Focus upon the details of situation, a reality behind these details, subjective meanings motivating actions.
Axiological: the researcher's view of the role of values in research	What is the role of value?	Value-free and unbiased. The researcher is independent of the data and maintains an objective stance.	Value-laden and biased. The researcher is part of what is being researched, cannot be separated and so will be subjective.
Rhetorical	What is the language of research?	Formal, based on set definitions, impersonal voice, and use of accepted quantitative words.	Informal, evolving decisions, personal voice, use of accepted qualitative words.
Methodological	What is the process of research?	• Deductive process. • Cause and effect. • Static design-categories isolated before study. • Context-free.	• Inductive process. • Mutual simultaneous shaping of factors. • Emerging design-

		• Generalisations leading to prediction, explanation, and understanding. • Accurate and reliable through validity and reliability.	categories identified during research process. • Context-bound. • Patterns, theories developed for understanding. • Accurate and reliable through verification.

Source: Adapted from Creswell (1994); Collis and Hussey (2003); and Saunders et al. (2009).

6.5 QUANTITATIVE AND QUALITATIVE METHODOLOGIES

Depending on process of the research being conducted, research methodology can be classified in two different categories: quantitative and qualitative (Collis and Hussey, 2003). Researchers should decide which approach would be the best for their research in terms of the nature of the research problem and data available (Collis and Hussey, 2003; Alshehri, 2012).

6.5.1 QUANTITATIVE APPROACH

Collis and Hussey (2003) provided a simple description of quantitative approach, which involves collecting and analysing numerical data and then applying statistical tests. The main concept of quantitative research is to build blocks of theory that represent the points around which social research is conducted (Bryman, 2012). Techniques that are used in quantitative research share language and logical forms based on positivism that distinguish them from qualitative research methods (Collis and Hussey, 2003; Neuman, 2006; Alshehri, 2012).

The main concerns of the quantitative approach are to build and establish a causal relationship between two or more variables and to predict or explain a relationship among various variables (Creswell, 2007; Alshehri, 2012). Bryman (2012) asserted that quantitative research can be interpreted as a research strategy that emphasizes quantification of data collection and analysis of data. Additionally, quantitative data collection and that:

- entails a deductive approach to study the relationship between theory and research, in which the accent is placed on the testing of theories;
- has incorporated the practices and norms of the natural scientific model and of positivism in particular; and
- embodies a view of social reality as an external, objective reality.

According to Collis and Hussey (2003) and Alshehri (2012), quantitative research methods include a variety of different designs including:

- cross-sectional studies,
- experimental studies consisting of true experiments and quasi-experiments,
- surveys including descriptive or analytical surveys, and
- correlational studies that aspire to discover or clarify relationships through the use of correlation coefficients.

Bryman (2012) mentioned that there are three main reasons for a preoccupation with measurement in quantitative research:

1. Measurement allows us to delineate fine differences between people in terms of the characteristics in questions.
2. Measurement gives us a consistent device or yardstick for making such distinctions.
3. Measurement provides the basis for more precise estimates of the degree of relationship between concepts through correlation analysis.

Denscombe (2007) discussed the advantages and disadvantages of quantitative data collection and analysis; the advantages are as follows:

1. Quantitative data is scientific, which means that the analyses appear to be based on objective law rather than the values of the researcher.
2. Quantitative data is more confident, which means that statistical tests of significance give researchers more credibility in terms of the interpretations they make and the confidence they have in their findings.
3. Quantitative research can be measured and provides a solid foundation for description and analysis.

4. Quantitative research can be analysed relatively quickly, provided that adequate preparation and planning has been done.
5. Quantitative research uses tables and charts, which are good or presentations. Computer software aids in the design of these tables and charts.

Denscombe (2007) described the disadvantages as follows:

1. Quantitative research is only as a good as the methods used and the questions that are asked, which means that it has limited uses.
2. There is a danger of researchers becoming obsessed with the techniques of analysis at the expense of the broader issues underlying the research.
3. A large amount of data can be an advantage of quantitative analysis, but it can lead to too many cases, variables, and factors to consider- the analysis, then, can be too complex.
4. Decisions made during the analysis of quantitative data can have far-reaching effects on the findings.

The current study applied quantitative methods to examine the relationship between corporate governance mechanisms and firm performance. The researcher used secondary data from the Saudi capital market and applied statistical and econometrics tests to examine this relationship. The researcher used ROA and Tobin's Q as a dependent variables while using board structures (board size, non-executive members, family board members, royal family board members and board committees) and ownership structure (managerial ownership, family or individual ownership, government ownership, foreign ownership, financial firms ownership, and non-financial firms ownership) as independent variables.

6.5.2 QUALITATIVE APPROACH

Collis and Hussey (2003) provided a simple description of qualitative approach, indicating that it is more subjective in nature and involves examining and reflecting on perceptions in order to obtain an understanding of social and human activities. Sandelowski (2004, p. 893) (as cited in Hammersley, 2013) defined quantitative research is "an umbrella term for an array of attitudes toward and strategies for conducting inquiry that are aimed at discovering how human being understand, experience, interpret, and produce the social world". In addition, Hammersley (2013, p. 12) provides a more specific definition of qualitative research, asserting that it is "a form of social inquiry that tends to adopt a flexible and data-driven research design, to use relatively unstructured data, to emphasize the essential role of subjectivity in the research process, to study a small number of naturally occurring cases in detail, and to use verbal rather than statistical analysis"

Bryman (2012) claimed that quantitative research can be construed as a research strategy that usually emphasizes words rather than quantification in the collection and analysis of data and that it:

- predominantly emphasizes an inductive approach to the relationship between theory and research, in which the emphasis is placed on the generation of theories;
- has rejected the practices and norms of the natural scientific model and of positivism, in particular, the emphasis on the ways in which individuals interpret their social work; and
- embodies a view of social reality as a constantly shifting, emergent property of individuals' creation.

Bryman (2012) listed all of the main research methods associated with qualitative research such as: ethnography/participant observation, qualitative interviewing, focus groups, language-based approaches to the collection of qualitative data (such as discourse and conversation analysis), and the collection and qualitative analysis of text and documents.

Denscombe (2007) described the principles of the qualitative approach as follows:

1. The first principle is that the analysis of the data and the conclusions drawn from the research should be firmly rooted in the data.
2. The second principle is that the researcher's explanation of the data should emerge from a careful and meticulous reading of the data.
3. The third principle is that the researcher should avoid introducing unwarranted preconceptions into the data analysis.
4. The fourth principle is that the analysis of data should involve an iterative process.

Denscombe (2007) discussed the advantages and disadvantages of qualitative approach; the advantages are as follows:

1. The data and analysis used in qualitative approach are grounded.

2. There is a richness and detail to the data.
3. There is tolerance of ambiguity and contradictions.
4. There is the prospect of alternative explanations.

Denscombe (2007) described the disadvantages as follows:

1. The data might be less representative.
2. Interpretation is bound up with the values of the researcher.
3. There is a possibility of decontextualizing the meaning.
4. There is a danger of oversimplifying the explanation.
5. The data analysis of qualitative method takes more time.

This current study also used a semi-structured interview to obtain a better understanding of the concepts of corporate governance in Saudi Arabia. Furthermore, the researcher asked the participants some questions to provide more explanation of the relationship between corporate governance mechanisms and firm performance to support the quantitative results (secondary data).

Table 6-7 Comparison between quantitative and qualitative research

Distinguishing Points	***Quantitative method***	***Qualitative method***
Paradigm	Positivism	Interpretivism
Research logic	Deductive	Inductive
Data used	Numerical	Linguistic
Points of orientation	View of researcher	View of participants
Sample size	Large sample	Small sample
Relationship with researcher	Passive	Active
Concepts	Examining theory	Developing theory
Characteristics	Presenting reality statically	Explaining processes
Research design	Structured	Unstructured
Scope of results	Generalizable	Specific
Sort of data	Hard and reliable	Rich and deep
Field	Macro	Micro
Concern	People's behaviour	Action based
Study field	Artificial settings	Natural settings

Objective of analysis	Analysing variables	Analysing individuals
Data presentation	Tables, relationships	Text extracted from interviews
Reliability	High	Low
Validity	Low	High
Strengths	• It can provide a wide coverage of a range of situations. • It can be fast and economical. • Statistical are accumulated from large samples. • It may hold considerable relevance to policy makers.	• Methods of conducting data is seen as natural. • It tends to evaluate change processes over time. • It aims to understand people's meanings. • It can generate theories.
Weaknesses	• Method may be seen as inflexible and artificial. • It does not support the understanding of actions. • It cannot generate theories. • It does not supported policy makers' decisions.	• More resources required for collecting data. • Difficulties in analysis and interpretation of data. • It is hard to control the whole process. • It could be less credibility is given by policy makers to this methods

Source: Adapted from (Amaratunga et al., 2002), (Bryman and Bell, 2003), (Corbetta, 2003), (Easterby-Smith et al., 2002) and (Collis and Hussey, 2009) (as cited in Alshehri, 2012).

6.6 COMBINED QUANTITATIVE AND QUALITATIVE METHODS - TRIANGULATION

Mixed methods research has become more common in business research, especially in the corporate governance field (Al-Saidi, 2012; Alshehri, 2012; Alghamdi, 2012). Saunders et al. (2012, p. 683) defined triangulation as “the use of two or more independent sources of data or data-collection methods within one study in order to help ensure that the data are telling you what you think they are telling you”. Collis and Hussey (2003) mentioned that the use of different research methods and techniques in the same study could overcome the potential bias and sterility of a single-method approach. Crowther and Lancaster (2009) articulate that the main reason for the applied triangulation method is because qualitative data, such as an interview, tends to be more detailed and more understanding about the research problem. At the same time, these details come from a small number of sources, and because a greater element of judgment is required in its analysis, it is apparent that there is a concomitantly greater need for mixed methods and data (triangulation).

Easterby-Smith et al. (1991) (as cited in Collis and Hussey, 2003) identify four types of triangulation:

- Data triangulation, where data is collected from different sources.
- Investigators triangulation, where different researchers independently collect data on the same phenomenon and compare the results.
- Methodological triangulation, where both quantitative and qualitative methods of data collection are used.
- Triangulation of theories, where a theory is taken from one discipline and used to explain a phenomenon in another area.

Bryman (2006); Greene et al. (1989); Molina-Azorin (2011) (as cited in Saunders et al., 2012) provided some reasons for using mixed methods:

1. Using mixed methods may allow meaning and findings to be elaborated, enhanced, clarified, confirmed and linked.
2. One method, such as qualitative, may be used to explain in more details the results of another method (quantitative) to examine the relationship between variables.
3. Using mixed methods may allow for greater diversity of views to inform and reflect upon the study.
4. Using an alternative method may help to interpret the unexplained results or insufficient data.
5. Using mixed methods may help to establish the generalisability of a study or its relative importance; also, it may help to establish the credibility of a study or to produce more complete knowledge.
6. One method may be used to focus on a single attribute or to answer one or more research questions, while the other method may be used to focus on and answer other research questions in the same study.

The current study employed both data triangulation and methodological triangulation to link and enhance the findings and results and also to give more details and explain the concept of corporate governance in Saudi Arabia with more credibility of the findings. The researcher used statistical and econometrics tests to answer the main research question, which is concerned with examining the relationship between corporate governance mechanisms and firm performance based on data collected from the Saudi Capital Market Authority, the Tadawul website, and board of directors reports from the company. Furthermore, the researcher used a semi-structured interview to explain in more detail and support the quantitative results and findings. The semi-structured interview tried to answer some of the researcher's questions, such as the concepts of corporate governance and the evaluation of the current regulations, which cannot be answered with regression analysis.

6.7 DATA COLLECTION METHODS

There are two main data sources: original data are the primary data and the next source is secondary data (Collis and Hussey, 2003). Primary data are collected at sources for specific phenomenon such as survey data gathered by questionnaires, observations, experiments, or interviews. In contrast, secondary data already exist in books, published statistics, and the annual reports of companies (Collis and Hussey, 2003). The following section explains the main tools used in this research, which are secondary data from the published statistics from the Saudi capital markets, annual reports from listed companies, and semi-structured interviews.

6.7.1 SECONDARY DATA

Saunders et al. (2007, p. 611) defined secondary data as "data used for a research project that were originally collected for some other purpose" Secondary data sources provide information that may be used for different research studies and purposes. It is therefore useful not only to find information to answer the research questions, but also to obtain a better understanding and explanation of the research problems (Ghauri and Grønhaug, 2005).

Data was obtained from the Tadawul website and the Capital Market Authority's website for the listed companies in the Saudi capital markets. The researcher used board of directors reports that were available from these two websites to obtain information about boards of directors (board size, non-executive members, family board members, royal family board members, and board sub-committees), and ownership structures (managerial ownership, family or individual ownership, government ownership, foreign ownership, financial firm ownership, and non-financial firms ownership). All data were available as a pdf file on these websites and the researcher extracted the information he needed and placed it in an Excel spreadsheet. For heightened reliability, data were checked by one colleague in the King Faisal University's School of Management to make sure it was accurate and complete. Regarding ROA, the data collected directly from the Tadawul website was in the form of a percentage and was thus, ready to use for the research. For Tobin's Q, the market value of each company's equity capital was collected from the Tadawul website and the ratio was then calculated using data from each company's financial statements.

This study's sample contained 458 observations of unbalanced data from non-financial firms in the Saudi capital market. Due to different regulations and capital structures, this study excluded firms in the banking and insurance sectors from the sample. In addition, the banking and insurance companies in the Kingdom of Saudi Arabia refer to Saudi Arabia Monetary Agency regulations. Also, there is missing data from among these five years due to the fact that the regulations of corporate governance in Saudi Arabia began as guideline codes and some codes were not mandatory. However, the Saudi Capital Market Authority demanded the listed companies comply with the regulations or explain why they failed to do so. Data were collected for five years (2007 to 2011; Tables 6-8). The rationale for using this study period was that the implementation of the best practices for corporate governance began in the beginning of 2007.

Table 6-8 Description of the Study's Data Samples

Description	2007	2008	2009	2010	2011	Pooled
The listed Saudi companies	122	134	144	146	150	696
Banking sector	11	11	11	11	11	55
Insurance sector	15	22	30	31	31	129
Missing annual reports and data	23	14	9	3	5	54
Final sample	73	87	94	101	103	458

6.7.1.1 Dependent and independent variables

This study used two indicators to measure firm performance: return on assets (ROA) and Tobin's Q as the dependent variables. The study also used some corporate governance mechanisms as independent variables that may have affected firm performance. The first variable is the Board of Directors (board size, non-executive directors, family board members, royal family board members and board committees). The second variable is ownership structure (managerial ownership, family or individual ownership, government ownership, foreign ownership, financial firm ownership and non-financial firm ownership).

Firstly, this research uses an accounting measure (ROA), which is earnings after tax and zakat (net income) divided by the total assets of the company (Mehran, 1995; Haniffa and Hudaib, 2006). The ROA is a backward-looking measure which reflects accounting rules and is used as a measure of productivity and profitability (King and Santor, 2008). According to Haniffa and Hudaib (2006, p. 1045), "a higher ROA indicates effective use of companies' assets in serving shareholders' economic interests" which means that managers' manipulation of their earnings and use of their firm's assets for their interests lead to a lower ROA and less effective use of the company's assets (Wiwattanakantang, 2001). The ROA was collected directly form the Tadawul website database as a percentage. The Tadawul website calculates the ROA as earnings after tax and zakat (net income) divided by the total assets of the company. In addition, all the listed companies use the same accounting policies for preparing the financial statemants. These policies are issued by the Saudi Orgnaization for Cerified Public Accountants (SOCPA).

Secondly, this research uses Tobin's Q to measure market valuations as a measure of firm performance. According to Haniffa and Hudaib (2006) and Abdullah et al (2011) , Tobin's Q is measured as the ratio of the market value (common share plus total debt) divided by the book value of the total assets of the company. However, there are number of methods to calculate Tobin's Q such as Yermack (1996) measured Tobin’s Q as the ratio of the firms’ market value divided by the replacement cost of their assets. Also, Chung and Pruitt (1994) defined Tobin’s Q as a market value of common stock share, the preferred stock and total liabilities divided by the total assets. The researcher calculate the Tobin's Q as the ratio of the market value of equity at the 31/12 plus the preferred stock for the firm (this value is omitted because the Saudi firms do not issue preferred stock) plus total liabilities divided by total assets as the majority of the literature used this method (Morck et al., 1988; Chung and Puitt, 1994; Agrawal and Knoeber, 1996; Davies et al., 2005; Omran et al., 2008)

King and Santor (2008) point out that Tobin’s Q is used to measure market performance; it is a forward-looking measure that reflects the market’s valuation of the firm’s assets relative to book value, and it is used as a proxy for a firm’s future growth opportunities. In addition, Weir et al. (2002, P.17) stated, “Q is a proxy for how closely shareholder and manager interests have been aligned” They also highlighted that a higher Tobin’s Q indicated more effective governance mechanisms and a better market perception of firm performance.

The independent variables used in this study were divided into two types: board structures and ownership structures as a table below

Table 6-9 Definitions of independent variables and their measures

Variable name	Symbol	Measures
Boards of Directors		
Board size	BSIZE	The total number of directors on the board (executive and non-executive).
Non-executive members	NEXE	The number of non-executive directors who sit on the boards of directors as identified by the company.
Family board members	FBM	The number of family members who sit on the boards of directors as they already have shares in the companies under the name of the family and they represent the family ownership of the

Variable name	Symbol	Measures
		company's shares.
Royal family board members	RFBM	Dummy variable, which takes a value of 1 if the board of directors have a member from royal family, and 0 otherwise. As identify with any member who is from the 'Al-Saud' family.
Board committees	BCOM	Dummy variable, which takes a value of 1 if a company has these committees (Audit, executive, nomination and remuneration), and otherwise is 0.
Ownership structures		
Managerial ownership	MANOWN	Measured by the proportion of shares owned by the board of directors of the company to the total of ordinary shares.
Family or individual ownership	FAMOWN	Measured by the proportion of shares owned by the family or individual to the total of ordinary shares.
Government ownership	GOVOWN	Measured by the proportion of shares owned by the government to the total of ordinary shares.
Foreign ownership	FOROWN	Measured by the proportion of shares owned by the foreign investors to the total of ordinary shares.
Financial firms ownership	FINOWN	Measured by the proportion of shares owned by the financial corporations to the total of ordinary shares.
Non-financial firms ownership	NFINOWN	Measured by the proportion of shares owned by non-financial investor ownership to the total of ordinary shares.

6.7.1.2 Control variables

The current study includes two control variables in the analysis that may affect the relationship between firm performance and corporate governance mechanisms; namely, firm size and industry types. These variables have been used in many previous studies to examine the relationship between corporate governance mechanisms and firm performance (Al-Saidi, 2010).

The first control variable is firm size (FSIZE), which is measured by the logarithm of the total assets (Mura, 2007). Short and Keasey (1999) argued that firm size may affect firm performance in two ways: 1) larger firms may find it easier to generate funds internally and to access funds from external sources (potential financial effect) and 2) the economies of scale that accompanies firm size allows the firm to create entry barriers with the associated beneficial effects on the firm performance.

Empirically, the relationship between firm size and firm performance is ambiguous and has had mixed results (Himmelberg et al., 1999; Ntim, 2009). Mehran (1995), Agrawal and Knoeber (1996), Bai et al. (2004), Chen et al. (2005), Cho (1998), and Anderson and Reeb (2003) report a negative relationship between firm size and firm performance. However, some studies found a positive relationship between firm performance and firm size, e.g., Wintoki et al. (2012). Haniffa and Hudaib (2006) found a positive relationship between firm size and ROA.

The second control variable is industry dummies (IND). This study includes industry dummies as control variables because the firm performance may also depend on the sensitivity of certain industries to changes in the macroeconomic factors (Haniffa and Hudaib, 2006). Haniffa and Hudaib (2006) found the construction sector performing better than its counterparts, which means the sector types perform differently. The industry dummies include manufacturing (IND 1) 'baseline', services (IND 2), foods (IND 3), investment (IND 4), and trading (IND 5) excluded.

6.7.2 INTERVIEW DATA

Interviews are a useful discussion between two or more people and can help a researcher to gather valid and reliable data related to the research questions and to achieve the objectives of the study (Saunders et al., 2007). According to Bryman and Bell (2007, p. 472), “the interview is probably the most widely employed method in qualitative research". Many types of interviews—structured, semi-structured and unstructured— are used in social sciences research.

Bryman and Bell (2007, p. 474) define the semi-structured interview as follows:

> The researcher has a list of questions on fairly specific topics to be covered, often referred to as an interview guide, but the interviewee has a great deal of leeway in how to reply. Questions may not follow on exactly in the way outlined on the schedule. Questions that are not included in the guide may be asked as the interviewer picks up on things said by interviewees. But, by and large, all the questions will be asked and a similar wording will be used from interviewee to interviewee.

Semi-structured interviews are a more flexible method that allows the researcher to ask new questions that arise from the interview and to gain rich information about the subject (Falgi, 2009). In addition, the main purpose of a semi-structured interview is to obtain a feeling for the respondent's attitudes and opinions about a specific situation (Baker and Foy, 2008). Furthermore, a semi-structured interview is designed to cover a range of issues about a specific subject in order to receive elaborated responses (Lillis, 1999). For this reason, the researcher in this study used a semi-structured interview to achieve the purposes of this study: to build a comprehensive picture of the corporate governance mechanisms in Saudi Arabia, to gain a deeper insight into how corporate governance operates in practice in Saudi Arabia and to obtain information about how key actors in corporate governance perceive that governance.

Accordingly, in this study, the researcher adopted a semi-structured interview to examine corporate governance mechanisms in the Saudi Arabia companies listed in the Saudi Arabian capital markets. The researcher asked various broad questions about corporate governance mechanisms, including general definitions and concepts. In addition, the researcher asked broad questions about the boards of directors and ownership structures of Saudi Arabian companies listed in the Saudi capital market. Finally, the interview questions sought to identify the relationship between corporate governance variables and firm performance.

The interview covered three main topics for corporate governance. The first topic included general definitions and concepts of corporate governance in Saudi Arabia. This section asked general questions about the stakeholders' views about their own definitions of corporate governance, how corporate governance is regulated in Saudi Arabian companies, the importance of Saudi codes of corporate governance and the challenges that arise with these codes.

The second topic was variables of boards of directors, including their responsibilities and roles, how they are structured and requirements for membership. In addition, this section asked general questions about non-executive directors. This part also covered some information regarding board size, family board members and CEO duality and board sub-committees. The researcher sought to examine the effects of the variables of a Board of Directors on firm performance.

The third topic of the interview was the ownership structures of Saudi Arabia companies. This part included some questions about managerial ownership, family ownership, government ownership and other stockholders' ownership. The researcher aimed to determine how ownership structure can impact firm performance.

The researcher used a non-probability sampling technique called the non-random sampling method (Saunders et al., 2012) to select interviewees. The researcher selected interviewees who would likely have knowledge and information about corporate governance mechanisms and who were likely to understand how these mechanisms function in the Saudi business environment. The researcher selected the study participants from Boards of Directors, large ownership stockholders, auditors, academic researchers and regulators, as these individuals could answer the research questions knowledgeably and assist the researcher in meeting the study's objectives. The researcher was fortunate in being able to gain access to all potential interviewees.

The researcher interviewed 17 participants from various stakeholders. Each participant had specific views about corporate governance in Saudi Arabia. The semi-structured interviews were conducted with board members (non-executives, CEOs, chairmen and secretaries), experienced shareholders, academics, a regulator, auditors and a government representative. The interviews were conducted in four cities in the Kingdom of Saudi Arabia (Alahsa, Dammam, Jubail and Riyadh) from February 2012 until end of April 2013. Interviews were conducted in Arabic and lasted between 45 and 70 minutes. Some of the participants agreed to have their interviews recorded, while others only agreed to note taking without recording. All participants were qualified, knowledgeable experts with experience in corporate governance and the Saudi capital markets. All interview data were trascribed verbatim in Arabic language into a Microsoft World file, the translation process takes long time, one hour of interview data need more than ten hours of translating from Arabic to English (Alshehri, 2012). Discussion and quotations passages were translated by the researcher to the English language.

Of the 17 participants (Table below), there were two nonexecutives with broad experience in Saudi joint-stock companies, three shareholders with a 5% or higher stake in joint-stock companies, two board secretaries responsible for preparing board-meeting agendas, one Capital Market Authority regulator, one government representative from the Board of Directors of joint-stock companies and two auditors. In addition, there were semi-structured interviews conducted with two academics who have a research interest in corporate governance and the Saudi capital markets. Furthermore, there were two interviews conducted with CEOs who have postgraduate degrees (Master's) and two chairmen. One of the chairmen has more than eight years of experience as a chairman in joint companies listed on the Saudi stock market, and the other comes from background in accounting and auditing, earned a PhD degree, and has worked as an external auditors for many years.

Table 6-10 Backgraounds of 17 interviewees

NO	Position	Code	Sector
1	Shareholder	SH1	Petrochemical Industries and Real Estate Development
2	Shareholder	SH2	Cement, Petrochemical Industries and Retail
3	Shareholder	SH3	Multi-Investment, Cement, Building and Construction, Agricultural and Food
4	Chief Executive Officer	CEO1	Building and Construction
5	Chief Executive Officer	CEO2	Industrial Investment
6	Chairman	CH1	Petrochemical Industries
7	Chairman	CH2	Hotel and Tourism
8	Regulator	R1	Capital Market Authority
9	Academic	AC1	King Faisal University
10	Academic	AC2	King Faisal University

11	Board Secretary	SEC1	Petrochemical Industries
12	Board Secretary	SEC2	Building and Construction
13	Auditor	AU1	Saudi Accounting
14	Auditor	AU2	Saudi Accounting
15	Government Representative member	GOV1	Public Pension Agency
16	Non-executive	NEXE1	Multi-Investment, Hotel and Tourism and Petrochemical Industries
17	Non-executive	NEXE2	Building and Construction, Banking and Insurance Industries and Energy and Utilities

Each interview started with an explanation of the objectives and the importance of this study by providing the participants with a copy of a brief description of this study. Appointments for the interviews were arrangement by telephone and email. All interviews were conducted face-to- face. Most of the interviews at the interviewees' office, and some of them preferred to meet in a coffee shop. Interviewees were provided with a copy of the letter from the researcher's supervisor and a copy of a brief descripion of this study.

6.8 SUMMARY

This chapter has described the research methodology and data collection method used, including the two types of research methods: a quantitative method (secondary data of the listed company in Saudi capital market) and a qualitative method (primary data collected from different stakeholders). This study adopted triangulation methodology to increase the confidence in the study (Alghamdi, 2012) and support the results from the secondary data. This study focuses on quantitative technique by using regression analysis to answer the main question of this study. After that, the researcher applies semi-structured interviews (qualitative) to interpret with more explanation and elicit the interpretation of the relationship between corporate governance and firm performance. Furthermore, the area of corporate governance and firm performance is still a new area in the Kingdom of Saudi Arabia, and need more knowledge to explore and interpret the phenomenon of corporate governance. For this reason, the researcher adopts triangulation methodology. Filatotchev and Nakajima

(2010) suggested thta the corporate governance research may incorporate a more qualitative understanding of outcomes of quantitative findings.

This study seems to involve a mixed paradigm, meaning that under the positivistic approach, it seeks to examine the facts or causes of the relationship between corporate governance mechanisms and firm performance. Additionally, however, this study used interpretivist paradigm by interpreting qualitative data (semi-structured interview) with a small number of participants in order to support the main results of the quantitative data, which focused on the details of situations or phenomena to better understand and explain the relationship between corporate governance mechanisms and firm performance.

The researcher used secondary data from the Saudi capital market and applied statistical and econometrics tests to examine this relationship. The researcher used ROA and Tobin's Q as dependent variables while using board structures (board size, non-executive members, family board members, royal family board members, and board committees) and ownership structures (managerial ownership, family or individual ownership, government ownership, foreign ownership, financial firms ownership, and non-financial firms ownership) as independent variables. Furthermore, this current study also used a semi-structured interview to obtain a better understanding of the concepts of corporate governance in Saudi Arabia. Furthermore, the researcher asked the participants some questions to provide more explanation of the relationship between corporate governance mechanisms and firm performance to support the quantitative results (secondary data).

Using both methods, known as triangulation, links and enhances the results as well as gives more details and explains the concept of corporate governance in Saudi Arabia, giving more credibility to the findings. The researcher used statistical and econometrics tests to answer the main research question, which is concerned with examining the relationship between corporate governance mechanisms and firm performance based on data collected from the Saudi Capital Market Authority, the Tadawul website, and board of directors reports from the company. Furthermore, the researcher used a semi-structured interview to explain in more detail and support the quantitative results and findings. The semi-structured interview was an attempt to answer some of the researcher’s questions regarding the concepts of corporate governance and the evaluation of the current regulations, which cannot be answered with regression analysis.

7 SECONDARY DATA RESULTS AND DISCUSSION

7.1 INTRODUCTION

This chapter discusses the results of the study's quantitative data (secondary data from annual reports). It seeks to achieve the main objective of this study, which is examining the relationship between corporate governance mechanisms and firm performance in Saudi Arabia. This study discusses that relationship by using various dependent and independent variables. The dependent variables reflect measures of firm performance, such as ROA and Tobin’s Q. The independent variables include corporate governance mechanisms, board structure (including board size, non-executive members, family board members, royal family board members and board sub-committees), and ownership structure (including managerial ownership, family or individual ownership, government ownership, foreign ownership, financial firms ownership and non-financial firms ownership). It first provides results of the Ordinary Least Square (OLS) analysis, after resolving some concerns related to the assumptions of OLS models. The OLS results provide a first view of the relationships between the independent and dependent variables, but statistical methods that mitigate the shortcomings of OLS are also utilised. This study thus provides the results of a two stage least squares model (2SLS) that addresses endogeneity and causality, while seeking to study the interdependent effects of corporate governance mechanisms and examines the impact of firm performance (ROA and Tobin’s Q) on those corporate governance mechanisms. Finally, this study uses a dynamic generalised method of moments (GMM) model to detect unobserved heterogeneity. GMM is applied for two main reasons: first, the failure to capture all influences of previous performance on current performance could leave models misspecified which may cause omitted variable bias; second, it can be argued that all older lags are exogenous with respect to the residuals of the present, which can then be used as instruments (Wintoki et al., 2012).

7.2 DATA

This study sample contains 458 observation from non-financial firms in the Saudi Capital Market. Data were collected for five years, from 2007 to 2011. This study used two indicators to measure firm performance: ROA and Tobin’s Q as a dependent variables. In addition, the study used some corporate governance mechanisms as independent variables which may have an effect on firm performance. The first variable is the board of directors (board size, non-executive directors, family board members, royal family board members and board committees); the second variable is ownership structure (managerial ownership, family or individual ownership, government ownership, foreign ownership, financial firm ownership, and non-financial firm ownership).

Focusing on the dependent variables, the mean ROA was 6.079 percent. The mean ROA in 2007 was 8.822 percent; it decreased in the same range for the other years, falling to between 5.997 and 5.160 percent. Al-Shiab and Abu Tapanjah (2005) showed similar results for ROA in 50 of the largest Jordanian industrial companies listed on the Amman Stock Exchange from 1996-2002. They found the mean ROA to be 7.7 percent. In addition, Omran et al. (2008) applied their study in several Arabic countries, in which they found that the mean ROA for Egypt was 7 percent.

The mean of Tobin's Q is 1.713. Dwivedi and Jain (2005) studied the relationship between corporate governance and firm performance for 340 large listed Indian firms for the period 1997-2001, determining that the mean of Tobin's Q was 1.71, the same results as in the current study. In addition, Haniffa and Hudaib (2006) examined the relationship between the corporate governance structure and performance of 347 companies listed on the Kuala Lumpur Stock Exchange, finding that the mean of Tobin's Q was 1.13 in Malaysia. Aljifri and Moustafa (2007) examined the impact of corporate governance mechanisms on firm the performance of 51 firms in the UAE, concluding that the mean of Tobin's Q was between 1.95 and 2.04. Also, Sulong and Nor (2010) found the mean of Tobin's Q of 403 firms listed on the Bursa Malaysia from 2002-2005 to be 1.83, which is in the same range as for this study.

On the other hand, for the independent variables, in the current study, the mean of the board size in Saudi companies was 8.310 with a maximum of 13 and a minimum of 4. The mean of the board size in Saudi Arabia aligned with Jensen (1993), who suggested that a board size of 7 or 8 members is easier for a CEO to control and also makes communicating with other members easier. In addition, the Saudi regulations for corporate governance (2006) suggested that board size should be no less than 3 and no more than 11. Vafeas and Theodorou (1998) studied the relationship between board structure and firm performance in 250 publicly traded firms in the UK; the mean of the board size of their study was 8.07, which is the same mean as the Saudi companies listed in the Capital Market. A study by Guest (2009) using a large sample, 2,746 UK-listed firms from 1981 to 2002, found the mean of the board size to be 7.18, which is not much different from the mean in this study. According to Mak and Kusnadi (2005), who examined the relationship between board size and performance across

Malaysian and Singaporean firms, the mean of the board size was 7.27, which it is not much different from the results in this current study. Sulong and Nor (2010) found the mean of the board size to be 7.972 for Malaysian firms for the period 2002–2005, which is the same as the mean number of members in the board of directors in this current study.

The mean of the non-executive directors in this study was 4.450. The mean of the board size in Saudi Arabia is around 8 members, and the Saudi regulations for corporate governance (2006) suggested that the majority of board members should be non-executives; our findings showed that the half the board members were non-executives. Solomon (2007) suggested that the presence of an adequate number of non-executives on a company board helps to reduce the notorious conflict of interest between shareholders and management. However, the non-executive members should have experience and knowledge to elevate the company performance and to perform competently (Agrawal and Knoeber, 2001). Clifford and Evans (1997) found the mean of number of non-executive directors for small companies to be 3.44; in medium-sized companies it was 4.14, and it was 5.41 in large companies. Laing and Weir (1999) found the same results as this study in their sample of 115 randomly selected UK companies; they found that the mean of non-executive directors in 1992 was 4.51 and was 4.93 in 1995.

For family board members, the mean was 1.120. Fama and Jensen (1983) argued that the existence of the family board member on the board of directors of the company give the company more advantages in monitoring and disciplining related to decision agents, which lead to reduced monitoring costs. According to Smith and Amoako-Adu (1999), the mean of family directors was 3.06 across Canadian companies, which is a different result from this study. However, in Saudi Arabia, family board members are widespread in family companies; other companies have few family board members because the individual or family need to own 5% or above ordinary shares in firms.

The mean of companies that have three board sub-committees increased from 24 percent in 2007 to 61 percent in 2011; the mean for all 5 years was 43 percent, indicating that the listed companies in Saudi Arabia increased commitment with these sub-committees during those years. The mean percentage of directors on the boards from the Saudi royal family was 20.5 percent. However, the mean of listed companies that have one or more royal family members sitting on the board of directors decreased from 23.2 percent in 2007 to 19.4 percent in 2011. This indicated that perhaps the royal family board members moved from non-financial firms to banking and insurance sectors, which led to a reduction in the percentage, or perhaps they lacked the experience or knowledge to sit as a board member.

The mean of managerial ownership was 9.597 %. This study revealed a low mean percentage in terms of managerial ownership. However, there are a few companies where management owns nearly all the shares. Davies et al. (2005) studied the relationship between managerial ownership and firm value in the UK, finding the mean of managerial ownership to be 13.02%. Short and Keasey (1999) studied the relationship between managerial ownership and performance in the UK from 1988-1992, concluding that the percentage of mean of managerial ownership in the ranged from 13.344% - 11.473%. However, Chen et al. (2003) examined how managerial ownership affected firm performance in 123 Japanese firms from 1987-1995, finding a low percentage in terms of the mean of managerial ownership (2%) in Japanese firms. A study conducted by Crutchley et al. (1999) in the New York Stock Exchange and the American Stock Exchange concluded that the mean of managerial ownership was 12.9% in 1987 and 14% in 1993, which agreed with Short and Keasey's (1999) results in the UK market.

The current study found low means of family and individual ownership according to the literature. This study found the mean of family or individual ownership is 11.124%. However, most other studies found higher results. For example, Chen et al. (2005) found 24.4% in 412 publicly listed Hong Kong firms during 1995-1998. In addition, Zeitun and Tian (2007) studied this relationship in 59 publicly listed firms in Jordan from 1989-2002, concluding that the mean of individual ownership in defaulted firms was 48.109% and 45.151% in non-defaulted firms. Shyu (2011) found the mean of family ownership 21.03% in Taiwanese listed companies. In the U.S., the mean of the family ownership is 85.46%.

The mean of government ownership in this current study is 8.714%. Al-Shiab and Abu-Tapanjah (2005) found that the mean of government ownership is 10.2% in Jordanian industrial companies listed on the Amman Stock Exchange. According to the U.S. Federal Reserve Flow of Funds, the Japanese Flow of Funds, the Deutsche Bundesbank Monthly Report, Dittus and Prowse (1996), and Claessens et al. (1996) (as cited in Xu and Wang, 1999), the mean percentage of government ownership in U.S. firms is 0%, in Japan it is 0.7%, in Germany it is 5%, in the Czech Republic it is 3.2%, and in China it is 30.9%. Additionally, Cueto (2008) found that the percentage of the mean of government ownership in Latin American firms is very low (1.65%).

The current study used foreign ownership as an independent variable. The mean of foreign ownership in this study was 1.480%; this percentage is very low because the Saudi capital market is still new in reference to worldwide investment. According to Douma et al. (2006), who studied the effect of foreign ownership on firm performance across 1,005 firms from 1999-2000 on the Bombay Stock Exchange, the mean of foreign ownership is 3.62%. However, Zeitun and Tian (2007) studied this relationship among 59 publicly listed firms in Jordan from 1989-2002, determining that the mean of foreign ownership in defaulted firms was 5.838%, and in non-defaulted firms it was 11.015%. In addition, according to the U.S. Federal Reserve Flow of Funds, the Japanese Flow of Funds, the Deutsche Bundesbank Monthly Report, Dittus and Prowse (1996), and Claessens et al. (1996) (as cited in Xu and Wang, 1999), the mean percentage of foreign ownership in U.S. firms is 5.4%, in Japan it is 4%, in Germany it is 14%, in the Czech Republic it is 3.4%, and in China it is 6.1%.

Another independent variable is financial firm ownership; the mean of financial firm ownership is 0.607%. According to Prowse (1992), the mean of the share held by financial institutions is 25% in Japan, which is a very large gap in reference to our current study. A study conducted in Japan by Morck et al. (2000) found the mean of ownership by financial block holders to be 14.50%. This current study found that the mean of shares held by non-financial firms was 14.721%. According to the U.S. Federal Reserve Flow of Funds, the Japanese Flow of Funds, the Deutsche Bundesbank Monthly Report, Dittus and Prowse (1996), and Claessens et al. (1996) (as cited in Xu and Wang, 1999), the percentage of non-financial corporation ownership in the U.S. is 14.1, which is the same result as in this current study. In Taiwan, the mean of the shares held by corporate firms is 18.63% (Filatotchev et al., 2005).

Table 7-1 Descriptive Analysis of Dependent and Independent Variables

Variables	Measures	2007 (N=73)	2008 (N=87)	2009 (N=94)	2010 (N=101)	2011 (N=103)	all (N=458)
ROA	Mean	8.822	5.997	5.160	5.695	5.420	6.079
	Median	8.360	6.300	3.390	5.880	5.350	5.679
	Standard deviation	7.845	11.579	8.165	9.292	11.875	10.018
	Skewness	0.412	-1.638	0.347	-0.347	-2.032	-1.247
	Kurtosis	0.404	11.650	1.328	4.115	14.835	11.197
	Minimum	-13.540	-58.980	-18.000	-30.210	-67.810	-67.810
	Maximum	27.100	43.450	29.910	38.610	43.980	43.980
Tobin's Q	Mean	2.343	1.295	1.596	1.574	1.862	1.713
	Median	2.220	1.160	1.375	1.350	1.450	1.430
	Standard deviation	0.995	0.541	0.714	0.776	1.108	0.911
	Skewness	0.847	1.984	1.789	1.942	1.797	1.766
	Kurtosis	0.713	5.627	3.691	4.361	3.485	3.687
	Minimum	0.533	0.540	0.730	0.680	0.670	0.533
	Maximum	5.320	3.870	4.620	4.910	6.600	6.600
Board Size	Mean	8.320	8.240	8.290	8.390	8.310	8.310
	Median	8.000	8.000	8.000	8.000	8.000	8.000
	Standard deviation	1.715	1.562	1.584	1.697	1.502	1.603
	Skewness	-0.032	-0.019	0.093	0.488	0.285	0.190
	Kurtosis	-0.514	-0.113	-0.032	-0.133	-0.446	-0.230
	Minimum	4.000	4.000	4.000	5.000	5.000	4.000
	Maximum	12.000	12.000	12.000	13.000	12.000	13.000
Non-Executive	Mean	4.320	4.460	4.810	4.370	4.270	4.450
	Median	5.000	5.000	5.000	4.000	4.000	4.000

Director	Standard deviation	3.395	3.117	3.146	2.641	2.272	2.894
	Skewness	-0.049	-0.184	-0.266	0.454	0.628	0.043
	Kurtosis	-1.438	-1.280	-1.182	-0.422	0.134	-0.975
	Minimum	0.000	0.000	0.000	0.000	0.000	0.000
	Maximum	10.000	10.000	10.000	11.000	10.000	11.000
Family Board Member	Mean	1.040	1.050	1.100	1.200	1.170	1.120
	Median	0.000	0.000	0.000	0.000	0.000	0.000
	Standard deviation	1.654	1.569	1.593	1.625	1.585	1.598
	Skewness	1.866	1.733	1.616	1.428	1.381	1.562
	Kurtosis	2.689	2.289	1.825	1.267	1.060	1.608
	Minimum	0.000	0.000	0.000	0.000	0.000	0.000
	Maximum	6.000	6.000	6.000	6.000	6.000	6.000
Board Sub-Committees	Mean	0.246	0.31	0.382	0.544	0.611	0.434
	Median	0.000	0	0	1	1	0
	Standard deviation	0.434	0.465	0.488	0.500	0.489	0.496
	Skewness	1.175	0.819	0.481	-1.178	-0.458	0.264
	Kurtosis	2.382	1.672	1.231	1.032	1.209	1.069
	Minimum	0	0	0	0	0	0
	Maximum	1	1	1	1	1	0
Royal Family Board Members	Mean	0.232	0.218	0.202	0.188	0.194	0.205
	Median	0.000	0	0	0	0	0
	Standard deviation	0.425	0.415	0.403	0.392	0.397	0.404
	Skewness	1.263	1.363	1.483	1.596	1.546	1.459
	Kurtosis	2.597	2.858	3.2	3.547	3.390	3.130
	Minimum	0	0	0	0	0	0

	Maximum	1	1	1	1	1	1
Managerial Ownership	Mean	9.10935	9.65509	9.69410	9.53056	9.87167	9.597
	Median	1.31000	1.37000	1.74450	2.08000	1.87300	1.664
	Standard deviation	15.47642	16.74956	16.58953	16.18805	15.74195	16.101
	Skewness	2.41300	2.83200	2.77500	2.78700	2.61800	2.675
	Kurtosis	5.98500	9.28900	9.12000	9.42700	9.09400	8.424
	Minimum	0.00005	0.00008	0.00000	0.00130	0.00100	0.000
	Maximum	70.00000	94.00000	95.06000	95.84000	95.86000	95.860
Family or Individual Ownership	Mean	10.261	11.388	10.808	11.677	11.340	11.142
	Median	0.000	5.000	0.333	5.300	5.670	0.333
	Standard deviation	15.870	17.598	17.144	17.511	16.735	16.959
	Skewness	2.012	2.340	2.426	2.134	2.233	2.220
	Kurtosis	4.138	6.471	7.145	5.437	6.401	5.811
	Minimum	0.000	0.000	0.000	0.000	0.000	0.000
	Maximum	67.500	94.000	95.000	95.000	95.000	95.000
Institutional Government Ownership	Mean	9.353	8.964	9.012	7.977	8.499	8.714
	Median	0.000	0.000	0.000	0.000	0.000	0.000
	Standard deviation	18.905	18.412	18.336	16.697	17.977	17.941
	Skewness	2.485	2.522	2.526	2.582	2.696	2.541
	Kurtosis	5.803	5.927	5.959	6.403	6.936	5.962
	Minimum	0.000	0.000	0.000	0.000	0.000	0.000
	Maximum	67.500	83.300	83.600	75.100	83.600	83.600
Foreign Ownership	Mean	0.986	1.497	1.545	1.566	1.670	1.480
	Median	0.000	0.000	0.000	0.000	0.000	0.000

	Standard deviation	4.503	6.289	6.219	6.048	5.994	5.881
	Skewness	5.275	4.466	4.351	4.392	4.141	4.415
	Kurtosis	28.151	19.596	18.854	19.571	17.958	19.416
	Minimum	0.000	0.000	0.000	0.000	0.000	0.000
	Maximum	28.800	37.500	37.500	37.500	37.500	37.500
Financial Firm Ownership	Mean	1.392	0.429	0.441	0.477	0.480	0.607
	Median	0.000	0.000	0.000	0.000	0.000	0.000
	Standard deviation	9.132	1.819	1.786	1.801	2.064	4.023
	Skewness	8.126	4.434	4.328	3.754	4.797	15.446
	Kurtosis	67.841	19.942	19.399	13.281	25.136	286.110
	Minimum	0.000	0.000	0.000	0.000	0.000	0.000
	Maximum	77.000	11.310	11.310	9.900	14.600	77.000
Non-Financial Firm Ownership	Mean	11.693	14.071	14.891	16.288	15.722	14.721
	Median	0.000	0.000	0.000	0.000	0.000	0.000
	Standard deviation	18.634	19.681	20.303	21.643	20.814	20.322
	Skewness	1.616	1.205	1.138	1.105	1.127	1.195
	Kurtosis	1.514	0.137	-0.062	-0.052	0.119	0.165
	Minimum	0.000	0.000	0.000	0.000	0.000	0.000
	Maximum	66.500	66.500	66.500	80.200	80.200	80.200

7.3 DIAGNOSTIC ANALYSIS OF THE ASSUMPTIONS FOR ORDINARY LEAST SQUARES (OLS)

The method of ordinary least squares (OLS) is attributed to Carl Friedrich Gauss, a German mathematician (Gujarati and Porter 2009). According to Gujarati and Porter (2009), this method has very attractive statistical properties that have made it one of the most popular and powerful methods of regression analysis because the OLS formulas are built into virtually all spreadsheet and statistical software packages (such as SPSS, STATA, others). This makes the OLS easier to use and its results are easy to read and analyse (Stock and Watson 2007). The OLS is a very famous approach analysis to test any relationship in the social sciences (Al-Saidi 2010). Most literature uses this method to examine the relationships between dependent and independents variables, especially in corporate governance studies (e.g., Baysinger and Bulter 1985; McConnell and Servaes 1990; Mehran 1995; Cho 1998; Short and Keasy 1999; Berger et al. 2005; Haniffa and Hudaib 2006; King and Santor 2008; and Omran et al. 2008).

This research tested the assumptions of OLS to determine which techniques would be appropriate for examining the relationship between corporate governance variables and firm performance. These assumptions include normality, linearity, homoscedasticity, multicollinearity, autocorrelation, and outliers (Dinga et al. 2009; Al-Saidi 2010). Firstly, we provide the assumptions of the classical linear regression model, which is the cornerstone of most econometrics theories, as these assumptions underlie the OLS method (Gujarati and Porter, 2009). According to Brooks (2008) and Gujarati and Porter (2009), there are some assumptions regarding the classic linear regression model (CLRM) that should be applied to assess the data:

1. The regression model is linear in the parameters for which the relationship between dependent and independent variables is linear.
2. Zero mean value of disturbance u_i: The average value of the errors is equal to zero, and the errors should be in a normal distribution.
3. Homoscedasticity, or constant variance of u_i, means the variance of the errors is constant.
4. No autocorrelation between the disturbance: The covariance between the error terms over time is zero, assuming that the errors are uncorrelated with one another.
5. No high relationships among the independent variables (multicollinearity).

6. No outliers in the values of X variables, which means values that are are very large (or small) in relation to the rest of the observations.

Secondly, we discuss in detail the assumption of the OLS to determine which technique will be appropriate for examining the relationships among corporate governance variables and firm performance. These assumptions include normality, linearity, homoscedasticity, multicollinearity, autocorrelation, and outliers (Dinga et al. 2009; Al-Saidi 2010). These assumptions as follows:

1. **Assumption of Normality**

The data with a normal distribution has the familiar bell-shaped probability density (Stock and Watson 2007) within standard skewness of ± 1.96 and standard kurtosis of ± 3 to be normal (Haniffa and Hudaib 2006). Most of the variables used in this study do not meet this assumption. In addition, this study tested the normality of each variable by graphical and numerical methods. The graphical methods such as scatter plots, P-P plot for the standard normal probability, and Q-Q plot were found to be sensitive to non-normality. In addition, this study also applied the numerical method to test normality, and the Shapiro-Wilk and skewness/kurtosis tests were used to test normality for the null hypothesis of no normal distribution and found it significant which indicates the non-normality.

2. Assumption of Linearity

The second assumption is that there is a linear relationship between dependent and independent variables (Al-Saidi 2010). This study checked the linearity between the predictors and outcome variables by histograms and plotting graphs, and it found some patterns of a linear relationship. However, with regard to some independent variables, it is difficult to establish linear relationships among corporate governance mechanisms and firm performance. Theoretically, some of the corporate governance mechanisms are non-linearly related with firm performance (Dinga et al., 2009)

3. Assumption of Homoscedasticity

The third assumption is the variance of error is constant, which is referred to as homoscedasticity (Verbeek, 2004; Gujarati and Porter, 2009). Stock and Watson (2007,p. 160) defined homoscedasticity (homoskedasticity) as " the error term u_i is homoskedastic if the variance of conditional distribution of u_i X_i is constant for i = 1, ..., n and in particular does not depend on X_i. Otherwise, the error term is heteroskedastic". Hill et al. (2008) documented that if the case is heteroskedasticity in the regression model and the research used the least square technique to estimate the unknown coefficient, then:

- The least square estimator is still a linear and unbiased estimator, but it is no longer the best linear unbiased estimator (B.L.U.E.).
- The standard errors usually computed for the least squares estimators are incorrect.

To detect homoscedasticity, the researcher applied the Breusch-Pagan test (Dinga et al. 2009). The Breusch-Pagan test shows the significant probability for the chi-square test, thus indicating a constant variance. This implies that homoscedasticity is not a problem in the data.

4. Assumption of Multicollinearity

According to Gujarati and Porter (2009), multicollinearity indicates the existence of a linear relationship among some or all independent variables of a regression model. Furthermore, the time series data are one of the reasons that may lead to multicollinearity (Gujarati and Porter 2009). Multicollinearity problems may lead to unreliable estimates with high standard errors and unexpected signs or magnitude (Verbeek 2004). The problem of multicollinearity occurs when the correlation between two independent variables exceeds 0.8 (Gujarati and Porter 2009; Al-Saidi 2010). Thus, in this study, managerial ownership and family or individual ownership may change over time at more or less the same rate, leading to multicollinearity between these two variables. For example, in family-dominated firms, managers are likely to be family members so there is a big overlap between family and managerial ownership, and because the share capital of a company remains more or less constant over time, increases in one type of ownership are likely to be associated with reductions in other types of ownership. Hence, the various ownership variables are not independent of each other.

To detect this problem, the Pearson correlation matrix is used to test the multicollinearity problem (Haniffa and Hudaib 2006). Furthermore, this study assessed the variance inflation factors (VIF) to check the level of multicollinearity (Dinga et al. 2009). The VIF of this study is more than 0.10 (1/1.78 = 0.56), indicating the existence of the multicollinearity problem (Dinga et al. 2009) between managerial ownership and family or individual ownership. According to Gujarati and Porter (2009), when the problem of multicollinearity exists, the researchers have two solutions. The first solution is to do nothing, as promoted by Blanchard (1967). Blanchard (1967, p. 449-451) stated, "Multicollinearity is God’s will, not a problem with OLS or statistical technique in general" (as cited in Gujarati and Porter 2009). The second solution applies one of the Rule-of-Thumb procedures, which is dropping one of the variables (Gujarati and Porter 2009). This study applied OLS with three types of regression: do nothing with multicollinearity, drop managerial ownership, and in the last regression, drop family or individual ownership.

Table 7-2 Correlation Matrix

Var.	***ROA***	***Tobin's Q***	***BSIZE***	***NEXE***	***FBD***	***MANOWN***	***FAMOWN***	***GOVOWN***	***FOROWN***	***FINOWN***	***NFINOWN***
ROA	1.000										
Tobin's Q	0.251	1.000									
BSIZE	0.091	-0.166	1.000								
NEXE	-0.092	-0.155	0.253	1.000							
FBM	0.210	0.039	0.051	-0.121	1.000						
MANOWN	0.101	0.038	0.047	-0.140	0.560	1.000					
FAMOWN	0.041	0.038	-0.019	-0.195	0.529	0.861	1.000				
GOVOWN	0.117	-0.012	0.104	0.092	-0.249	-0.211	-0.178	1.000			
FOROWN	-0.153	-0.087	0.157	0.173	-0.150	-0.094	-0.143	-0.071	1.000		
FINOWN	0.053	0.035	-0.009	-0.059	0.076	0.168	0.191	-0.038	-0.013	1.000	
NFINOWN	0.077	-0.009	-0.027	0.127	0.017	-0.074	-0.120	-0.252	0.076	-0.093	1.000

Table 7-3 Variance Inflation Factor

Variables	VIF	1/VIF
MANOWN	4.53	0.220711
FAMOWN	4.27	0.234267
FSIZE	2.20	0.45555
GOVOWN	1.97	0.507494
FBD	1.83	0.545912
IND1	1.47	0.679379
FOROWN	1.36	0.737939
NFINOWN	1.31	0.765179
IND1	1.28	0.783667
IND2	1.27	0.785980
BSIZE	1.67	0.792585
NEXE	1.23	0.815537
IND3	1.18	0.845661
RFBM	1.17	0.851250
FINOWN	1.10	0.909237
BCOM	1.09	0.915535

Variance Inflation Factor: Mean of VIF is 1.78

5. Assumption of Autocorrelation

Kendall and Buckland (1971, P.8) defined the term of autocorrelation as "correlation between members of series observations order in time [as in time series data] or space [as in cross-sectional data]" (as cited in Gujarati and Porter 2009). In the panel data values (observations for the same firm over several consecutive periods) that come from the same variables among various times and may be the errors of different observations are likely to be highly correlated (Dinga et al.; 2009). There are various tests to detect the problem of autocorrelation such as Durbin-Watson and Breusch-Godfrey tests (Gujarati and Porter, 2009). According to Verbeek (2004), when a value of Durbin-Watson (DW) is much smaller than 2, this indicate a positive autocorrelation. The DW of this study is lower 2 (0.675), which shows that there is evidence of a positive autocorrelation. The DW lower and upper values for our data are 1.654 and 1.885, respectively. The DW value is 0.675, which is below 1.654 (lower value) and is evidence that there is a positive autocorrelation at a 5% significant level.

6. **Assumption of Outliers**

An outlying observation or outlier is an observation that is very unlike the observations in the sample (Gujarati and Porter, 2009). In addition, Gujarati and Porter (2009) defined an outlier as an observation with a large residual. Outliers can make the ordinary least squares (OLS) results misleading (Stock and Watson, 2007). The presence of outliers cause the problem of non-linearity (Ntim, 2009). In this research, outliers were inspected and we tried to overcome the problem of outlying observations by winsorising, which is a process of replacing the outlier observations with the mean plus (or minus) three standard deviations (Abdullah, 2007). This helps to minimise potential serious violations of OLS regression assumptions such as normality and linearity, upon which the regression analysis will be based (Ntim, 2009).

As mentioned above, OLS regression offers three types of solutions for the multicollinearity problem: do nothing with multicollinearity, drop managerial ownership, and in the last regression, drop family or individual ownership. All of these regressions have been applied after winsorising. In terms of the six problems of OLS mentioned above, this study addressed multicollinearity by omitting correlated variables, and it has addressed outliers by winsorising. However, our data still have the problems of non-normality and non-linearity of some variables and we tried to solve these problems by winsorising. However, theoretically, some of the corporate governance mechanisms related non-linearly with firm performance. This research has a potential problem with autocorrelation. The OLS results provide a first view and direction of the relationships between independent and dependent variables, but statistical methods that mitigate the shortcomings of OLS are worth using. Hence, this study uses various other methods.

7.4 ORDINARY LEAST SQUARE (OLS) RESULTS

The first regression technique used in this study was the ordinary least square (OLS), considering the performance measures as dependent variables and the corporate governance mechanisms and control variables as independent variables. This section is divided into two subsections: the first presents the OLS regression results of ROA regarding the corporate governance mechanisms; the second presents the OLS regression results of Tobin's Q with the corporate governance mechanisms.

This study divided the OLS technique into three models to overcome the problem of multicollinearity. Because of the multicollinearity between managerial ownership and family or individual ownership, in the second model, this study dropped the family or individual ownership and applied the OLS again to see if there was any effect. In the third model, this study dropped the managerial ownership from the regression and applied the OLS to see what changed.

7.4.1 RESULTS BASED ON THE RETURN ON ASSETS (ROA)

Table 1 presents the results of OLS regression of ROA on the corporate governance variables and control variables. The first column presents the first model of the OLS, which includes all corporate governance variables with control variables as independent variables. The second and third columns discuss the results without family or individual ownership; and without managerial ownership, respectively. The first model shows that the *F* value of 8.05 for all 5 years is significant at the 1 percent level. The adjusted R^2 is about 20% for the entire sample, which mean the proportion of the total sample variation in ROA that is explained by the independent variables.

The coefficient on the percentage of board size, family board member and royal family board member are statistically positive significant with ROA at 5%, 1%, and 5%, respectively, whereas the coefficient on the non-executive board member and board committees are negative but not significant. Regarding the ownership structure, this study finds the coefficient on managerial ownership, government ownership, and non-financial firms' ownership are statistically positive significant: 5%, 1%, and 1%, respectively. By contrast, family or individual ownership and foreign ownership have statistically negative effects on the ROA.

To start with, the coefficient on board size (BSIZE) is positively significant over the entire sample period. There is a statistical significance at a level of 5% and a positive relationship between board size and ROA. This result supports some of the previous studies (Loderer and Peyer, 2002; Haniffa and Hudaib, 2006). For instance, Haniffa and Hudaib (2006) reported a statically significant and positive relationship between board size and ROA among 347 listed companies in Kuala Lumpur for the period 1996 to 2000. This study grew out of research by Zahra and Pearce (1989). They suggested that large board size related positively to company financial performance: they found a positive relationship and assumed a large board size to have directors with diverse backgrounds, skills, and experience.

Non-executive board member (NEXE) has an insignificant relationship with ROA. It supports some previous corporate governance studies that focused on the non-executive member (Baysinger and Butler, 1985; Mehran, 1985; Klein, 1998; Haniffa and Hudaib, 2006). This result supports the findings of Haniffa and Hudaib (2006) who found the non-executive member not to be significantly related with ROA. This study expected that the non-executive member’s ownership in general would not be significant enough to give them an incentive to monitor the firm (Mehran, 1995). In Saudi Arabia, some non-executive members (who do not represent family ownership) are required to own at least 1,000 shares in the company (1000*10 = SR 10000 market value); this small amount does not give the non-executive too much power to monitor the company.

This study found a statistically significant and positive coefficient between the presence of a family board member (FBM) on the firm’s performance. A number of Saudi listed companies have elected family members to sit on the board as executives (CEO) or non-executives. It supports some previous studies, such as Maury (2006) and Sanda et al. (2005), which indicated a positive relationship between a family board member and firm performance. This positive relationship occurs because these families have power as well as good access to company information, which leads to improved firm performance (Al-Saidi, 2010).

The results suggested the presence of a royal family board member (RFBM) on the board of directors is statistically positively related to ROA. The existence of a royal family board member might increase the firm’s performance because they tend to own large numbers of shares in companies. In addition, they expose the firm to a competitive environment, which leads to improved firm performance (Aghamdi, 2012).

This study also found a statistically insignificant relationship between board committees (BCOM) and ROA. The current study result is consistent with the findings of Vafeas and Theodorou (1998), who studied this relationship among 250 firms in the UK in 1994. They concluded that these committees did not have a significant effect on firm performance. Our results indicate that the majority of the board members in the board sub-committees are non-executives; they did not have much knowledge or experience related to the function of the sub-committees. For example, an audit sub-committee needs members with accounting backgrounds. This study suggests including sub-committees with insider members (executive) who have good backgrounds related to the sub-committee's purpose and also have information about the company. Klein (1998) suggested that inside directors can be valuable board members in sub-committees.

The results suggested that managerial ownership (MANOWN) is a highly significant statistic with ROA. This result is consistent with Owusu-Ansah (1998), Mangena and Tauringana (2008), and Kapopoulos and Lazaretou (2007), who found a positive relationship between ROA and managerial ownership. Theoretically, the positive coefficient can be explained by the convergence of interests. This hypothesis states that managers who own large shares have additional incentives to monitor managerial actions that help to reduce agency costs and enhance firm performance (Ntim, 2009).

The current study found a highly negative significant relationship between family or individual ownership (FAMOWN) and ROA, at a 1% level. This result indicated poor legal investor protection in some developing countries (Omran et al., 2008). Omran et al. (2008) found that family or individual ownership had a negative and significant impact on firm performance. This result indicates that family ownership interest appears to expropriate the minority, which means the family looks after its own interests to such an extent that residual profits available for minority shareholders are limited (La Porta et al., 1999; Shyu, 2011).

This study also found a highly significant positive relationship between government ownership (GOVOWN) and ROA, at a 1% level. Our result is supported by the findings of Sun et al. (2002) and Omran et al. (2008), who examined the relationship between government ownership and firm performance and found a positive relationship. In addition, the Saudi government supports and funds the Saudi Stock market to get better performance by owning a substantial portion of the listed companies in the Saudi capital market. This may explain the strong positive relationship between firm performance and government ownership. In addition, the existence of the board member who represents any government agency that owns shares in a company has the incentive and power to monitor and control management and also plays a significant role in corporate governance (Xu and Wang, 1999).

Foreign ownership (FOROWN) had a highly negative significant on the ROA, at a level of 1%. Empirically, it supports the results of Lehmann and Weigand (2000). They found a negative relationship between foreign ownership and ROA among 361 German corporations for the period 1991-1996. Also, Al-Shiab and Abu-Tapanjeh (2005) found a negative relationship between foreign ownership and ROA in one of the Arab countries (Jordan).

This study found a statistically insignificant relationship between financial firm ownership (FINOWN) and ROA. The reason is the majority of the financial firms own shares in banking and insurance corporations, and our data contains all companies listed in the Saudi Stock market, excluding banking and insurance corporations. Moreover, financial firm ownership has a strong effect on banking and insurance corporations.

Non-financial firm ownership (NFINOWN) is found to be positively significantly related to ROA. This finding is similar to those of several previous studies (Gorton and Schmid, 2000; Morck et al., 2000; Filatotchev et al., 2005). Gorton and Schmid (2006) argued that outside block shareholders played a vital role in monitoring management. They reasoned that the large size of the portion of stock share of outside shareholders gave them more incentive to oversee management and enhance firm performance and work quality.

This study found a negative effect with respect to the control variables: firm size (FSZIE) and industry types (IND). The negative coefficient on firm size offers empirical support to past evidence that suggested a negative relationship between firm size and ROA (e.g.; Mehran, 1995; Agrawal and Knoeber, 1996; Bai et al., 2004; Chen et al., 2005). In addition, the coefficient of all industry types had a negative effect on firm performance.

Because of the problem of the multicollinearity between managerial ownership and family or individual ownership, the second model examined the relationship between corporate governance mechanisms (without family or individual ownership) on ROA. The second model found the approximately the same results of the first model, with some differences regarding managerial ownership, which is found insignificantly related with ROA. Also, the third model (without managerial ownership) did not find differences from the first model, except family or individual ownership, which is insignificantly related with ROA.

Table 7-4 OLS Regression of ROA on Corporate Governance Mechanisms

Ind. Var.	1	2	3
Constant	11.19 **	11.37 **	10.56 **
BSIZE	0.578 **	0.629 *	0.623 **
NEXE	-0.150	-0.111	-0.141
FBD	1.28 ***	1.18 ***	1.52 ***
BCOM	-0.4	-0.395	-0.569
MANOWN	0.139 **	0.034	-
FAMOWN	-0.126 ***	-	-0.038
GOVOWN	0.152 ***	0.154 ***	0.144 ***
FOROWN	-0.22 **	-0.190 *	-0.209 *
FINOWN	0.133	0.046	0.128
NFINOWN	0.006 ***	0.070 ***	0.066 ***
RFBM	2.51 **	2.64 **	3.09 ***
IND1	-3.47 ***	-3.66 ***	-3.548 ***
IND2	-3.75 ***	-4.36 ***	-4.119 ***
IND3	-6.26 ***	-6.38 ***	-6.154 ***
IND4	-1.10	-1.36	-0.753
FSIZE	-1.73 **	-1.89 **	-1.687 **
R^2	0.226	0.214	0.215
Adj. R^2	0.198	0.187	0.188
F-value	8.05	8.02	8.07

7.4.2 RESULTS BASED ON TOBIN'S Q

Table 2 contains OLS regression results for the corporate governance mechanisms based on Tobin's Q. Similarly, the variables investigated in this model are eleven variables of corporate governance and two control variables. The first model presents the OLS technique, which includes all corporate governance variables with control variables as independent variables. The second and third models discuss the results of without family or individual ownership, and without managerial ownership, respectively. The first model shows that the *F* value of 9.12 for all 5 years is significant, at the 1 percent level. The adjusted R^2 is about 22% for the entire sample.

To begin with, various board structure variables (board size, non-executive members, family board members, royal family board members, board committees) are not significant in the Tobin's Q regression. There may not be much variation in practice in the independent variables. This could be the case if Saudi listed companies comply in form with the corporate governance codes, and their board structures are more or less the same (little variation in board size, non-executive members, family board members, royal family board members, board committees). However, these are probably not convincing reasons, because a lack of variation in board structure variables would also lead to insignificance as regards ROA.

Return on assets (ROA) is backward-looking, while Tobin's Q is forward-looking and is based on investors' expectations. It is quite consistent for investors to believe that board structure does not matter to future performance, perhaps because the investors think that the board of directors are not an important aspect of corporate decision-making governance, while in practice it does make a difference to performance. The actual effect on performance would show up in ROA, but the investors' belief that board structure is irrelevant would lead to no statistical significance in Tobin's Q.

To conclude, there are two possible explanations. The first is that investors are correct in their beliefs for the future, even though in practice they were incorrect in the past. As board structures become less varied and converge on the corporate governance code's model, board structure variables will have less impact on ROA. The second is that investors are incorrect in their beliefs for the future, and board structures could potentially add value. In that case, we would expect board structure variables to become statistically significant for Tobin's Q if the analysis were replicated in a few years' time.

In contrast to the ROA, the coefficient on the managerial ownership (MANOWN) and family or individual ownership (FAMOWN) are insignificant over the entire sample period with Tobin's Q. Our result is consistent with Agrawal and Knoeber (1996) and Faccio and Lasfer (1999), who found insignificant relationships between managerial ownership and Tobin's Q. This result suggests that both managerial ownership and family or individual ownership do not create or destroy firm value (Faccio Lasfer, 1999).

Similar to the results of the ROA, the government ownership (GOVOWN) is highly significant with a positive effect on Tobin's Q. This finding is in line with the results of Sun et al. (2002). Also, our result is consistent with Omran et al. (2008), who investigated the relationship between Tobin's Q and government ownership in different Arab countries; they found a positive relationship. This result is supported by Shleifer and Vinshny's hypothesis (1986) that large shareholders may help to reduce the free-rider problem of the minority shareholders, which leads to increased firm value. Tobin's Q measure reflects the market's valuation of the firm's assets relative to book value and it is used a proxy for a firm's future growth opportunities (King and Santor, 2008). This indicates government ownership leads to increased firm value in the future by supporting listed companies with more funds, allowing greater investments and increasing the number of employees in the company. A number of studies have documented that government ownership has had a political objective, such as excess employment, rather than profit maximization (Xu and Wang, 1999). This argument is true, but when the listed companies employ more employees, this can lead to increased profit per work hour and value added to the company (Xu and Wang, 1999).

In contrast to the ROA, the coefficient on the foreign ownership (FOROWN) is statistically positively significant with Tobin's Q. In an emerging market such as Saudi Arabia, listed companies need to enhance firm value by additional assistance from foreign investors to reach good future firm value. This finding is in line with the results of several previous studies (Dimelis and Louri, 2002; Bai et al., 2004; Douma et al., 2006; Sulong and Nor, 2010). Tobin's Q indicates that expected higher foreign ownership gives the company advanced technology and experience and enhances firm value in the future (Dimelis and Louri, 2002). The impact of foreign ownership on the Tobin's Q is positive because they provide good resources and capabilities that lead to increased future growth opportunities (Douma et al., 2006).

The result of the financial firms ownership (FINOWN) is insignificantly related with Tobin's Q. This result indicated the same reason as the ROA: because the majority of the financial firms own shares in the banking and insurance corporations and our data contains all companies listed in the Saudi stock market, excluding banking and insurance corporations. Moreover, financial firm ownership has a strong effect on banking and insurance corporations. In addition, Tobin's Q seems to be insignificant in the future with financial firms' ownership, which means that the financial firms will not have any plan to invest money in non-financial listed companies and will continue to focus on the banking and insurance sectors in the Saudi capital market.

Similar to the results of the ROA, the non-financial firms ownership (NFINOWN) is highly significant with a positive effect on Tobin's Q. This result is consistent with La Porta et al. (1998), who stated that large blockholders seek to solve agency problems and received a good return on investment. This finding is also supported by Morck et al. (2000), who found a positive relationship between Tobin's Q and non-financial ownership. Moreover, large shareholders such as corporations can reap large benefits for themselves and other shareholders by becoming informed and possibly by influencing corporate outcomes because they hold a block of voting right power (Zeckhauser and Pound, 1990).

With respect to the control variables, firm size (FSIZE) is statistically significant with a negative effect on Tobin's Q. This is supported by some of the previous studies (e.g., Mehran, 1995; Agrawal and Knoeber, 1996; Cho, 1998; Anderson and Reeb, 2003). In addition, industry types are included as a control variable. Haniffa and Hudaib (2006) found firm performance depended on the sensitivity of certain industries to changes in macroeconomic factors. The manufacturing and food industries have negative effects on Tobin's Q.

Because of the problem of the multicollinearity between managerial ownership (MANOWN) and family or individual ownership (FAMOWN), this study applied the relationship between corporate governance mechanisms without family or individual ownership in the second model, and without managerial ownership in the third model. This two models found exactly the same results of the first model, except that a royal family board member (RFBM) is significant at the 10% level with a positive effect on Tobin's Q in the third model (without managerial ownership). This indicates that when the company reduces the shares owned by managers, the royal family board member has a positive effect on Tobin's Q in the future.

Table 7-5 OLS Regression of Tobin's Q on Corporate Governance Mechanisms

Ind. Var.	1	2	3
Constant	5.745 ***	5.757 ***	5.719 ***
BSIZE	-0.0165	-0.015	-0.014
NEXE	-0.007	-0.007	-0.007
FAMBD	0.010	0.009	0.020
BCOM	-0.107	-0.107	-0.113
MANOWN	0.005	0.004	-
FAMOWN	-0.001	-	0.002
GOVOWN	0.017 ***	0.0177 ***	0.017 ***
FOROWN	0.028 ***	0.029 ***	0.029 ***
FINOWN	0.012	0.011	0.011
NONFIN	0.006 ***	0.006 ***	0.006 ***
ROYALFBM	0.154	0.156	0.177 *
IND1	-0.29 ***	-0.302 ***	-0.302 ***
IND2	-0.028	-0.035	-0.042
IND3	-0.455 ***	-0.456 ***	-0.450 ***
IND4	0.111	0.108	0.125
FSIZE	-0.644 ***	-6.466 ***	-0.642
R^2	0.248	0.248	0.246
Adj. R^2	0.221	0.223	0.221
F-value	9.12	9.74	9.65

7.5 THE METHODOLOGY OF TWO STAGES LEAST SQUARES (2SLS)

The two stages least squares (2SLS) developed by Henri Theil and Robert Basmann (Gujarati and Porter, 2009). The main idea of the 2SLS regression is that the OLS will run twice for each independent variable. In the first stage, the corporate governance variables are assumed to be endogenous variables. Each endogenous variable is taken up as dependent variable and regressed against its lagged value for one year for the same variable with other corporate governance variables and control variables (Abdullah, 2007). The first OLS regression is:

Endogenous variables (independent variables) = indep_{n-1} + other corporate governance variables + control variables

The above regression is run to obtain the predicted value of each endogenous variable (independent variables). Then, the predicted value of each independent variable is used to replace the original independent value and regressed again, using the equation below:

Firm performance = predicted value of each independent variable + control variables.

Gujarati and Porter (2009) discussed some features of 2SLS:

- It can be applied to an individual equation in the system without directly taking into account any other equations in the system. For example, the SPSS software applied 2SLS in one equation.
- It provides only one estimate per parameter.
- It is easy to apply because all one needs to know is the total number of exogenous variables in the system without knowing any other variables in the system.

7.6 RESULTS OF TWO STAGE LEAST SQUARES (2SLS) REGRESSION

This study discusses the results of the 2SLS regression of the relationship between firm performance (ROA and Tobin's Q) and corporate governance mechanisms (board of directors and ownership structure). The following table reports the results of the 2SLS that examined the relationship between firm performance and corporate governance variables. This study utilized two measures of firm performance (ROA and Tobin's Q) as dependent variables, and corporate governance mechanisms (board and ownership structure variables) as independent variables.

Table 7-6 2SLS Regressions of ROA and Tobin's Q on Corporate Governance Mechanisms

Independent variables	Dependent variables	
	ROA	**Tobin's Q**
Constant	2.458	5.418 ***
BSIZE	0.806 *	-0.002
NEXE	-0.490 *	-0.014
FBM	1.064 **	0.017
BCOM	-1.106	0.008
MANOWN	0.164 *	-0.005
FAMOWN	-0.147	0.007
GOVOWN	0.117 ***	0.017 ***
FOROWN	-0.126	0.024 ***
FINOWN	-0.213	-0.003
NFINOWN	0.052 *	0.007 ***
RFBM	3.537 ***	0.241 **
IND1	-4.551 ***	-0.367 ***
IND2	-3.775 **	0.093
IND3	-5.415 ***	-0.388 ***
IND4	-0.319	0.339 *
FSIZE	-0.147	-0.280 ***
R^2	0.194	0.282
Adj. R^2	0.156	0.249
F-value	5.11 ***	8.34 ***

The table above (7-6) displays the results of the ROA and Tobin's Q, which regressed against the board of directors and the ownership structure using two stage least square regression (2SLS). According to the ROA, this study found some results such as government ownership (GOVOWN) and royal family board members (RFBM) that are highly significant and positively related to ROA. The main point of these two variables is to provide and fund some of the listed companies, specifically petrochemical and service companies, with high resources to assist and support the infrastructure of the country.

The royal family board members are one of the aristocratic classes in the Kingdom of Saudi Arabia that have good power and responsibility for the renaissance of the country. Unfortunately, not many studies examine the relationship between royal family board members and firm performance. Alghamdi (2012) commented that the presence of a royal family member on the board might increase the firm's value because the royal family has an informal network of relatives and associates whose presence leads to improved performance. In terms of royal family board members, the results from the 2SLS indicate a positive and significance at 1% level with ROA and a significance at 5% with Tobin's Q, which leads me to conclude that the presence of the royal family on the board of directors increases firm performance and market valuation.

Regarding government ownership (GOVOWN), this study found highly positive significant effects of government ownership on the ROA at 1 % level. Most of the government ownership in Saudi Arabia is distributed in the utility and services sector (Alghamdi, 2012). A number of studies have investigated the relationship between firm performance and government ownership. This results are consistent with Xu and Wang (1999) who found a positive relationship between firm performance (ROA) and government ownership. In addition, Firth et al. (2002) examined the relationship between government ownership and ROA in the China Stock Market for the period of 1998 to 2000 and used the 2SLS method to examine this relationship. They found a positive relationship between government ownership and ROA.

In terms of board size (BSIZE), the results demonstrate a positive relationship with ROA at the 10% level. De Andres et al. (2005) examined the relationship between ROA and board size in 10 OECD countries, and they found a positive relationship between board size and ROA by utilizing an instrumental variables method. These results indicated that board size increases firm performance by enabling the firm to obtain easy environmental linkage, providing more resources, and increasing the possibility for interlocking directorates among board members and other firms (Hillman and Dalziel, 2003; Abdullah, 2007).

These findings demonstrate that the percentage of non-executive directors (NEXE) is significant at the 10% level with a negative effect on ROA. Indeed, these results are supported by stewardship theory, which suggests that non-executive directors are more often less knowledgeable about the business and find it more difficult to understand the complexities of the firm (Ntim, 2009). Abdullah (2007) used 2SLS to examine the relationship between independent board members and ROA for a sample period of six years (1999 to 2004). For FTSE 350 non-financial companies, Abdullah's study found a negative relationship between board independence and ROA.

In terms of managerial ownership (MANOWN), the 2SLS analysis revealed that the coefficient on managerial ownership is positive and significant at 10%. This result suggests that the existence of managerial ownership leads to an increase in ROA depending on convergence of interest. Ntim (2009) argued that when directors own a number of shares in the company it can lead to reducing the agency cost and to enhancing firm performance. Our results related to managerial ownership are roughly consistent with Beiner et al. (2006), where they found a positive relationship between managerial ownership and firm performance under the problem of endogeneity. In addition, Kaserer and Moldenhauer (2008) concluded that insider ownership had a positive effect on firm performance when they applied 2SLS regression to 648 firm observations for the years of 1998 and 2003 in Germany. The case of managerial ownership in Germany is very similar to that in Saudi Arabia, because managerial ownership in Germany is strongly related to family ownership (Kaserer and Moldenhauer, 2008).

Regarding foreign ownership (FOROWN) and financial firm ownership (FINOWN), this study did not observe any significant effect on ROA. Both of these two types of ownership have a negative effect on ROA. Financial ownership had a insignificant effect on ROA but this does not matter because the sample focused on the non-financial listed companies in the Saudi Capital market. Most financial firm ownership in the Saudi capital market is distributed in bank and insurance companies, and this study excluded these two sectors from the sample. In addition, foreign ownership has a negative effect on ROA. The main reason behind this insignificant is that foreign investors are not allowed to trade on the Saudi Stock Market in the first stage, and only Saudi nations are permitted to trade in the Saudi capital market (Albarrak, 2011). According to Albarrak (2011), only three firms had foreign owners during January of 2012, and none of them had more than 10% of total shares. Our data analysis statically found that the mean of foreign ownership in this study was 1.480%; this percentage is very low because the Saudi capital market is still new in reference to worldwide investment which consistent with Albarrak (2011). Currently, the Saudi capital market is one of the attractive capital markets in the developing countries, which leads to increases in the foreign investment in the future and enhances firm performance.

The 2SLS found a positive and significant at 5 % level for family board members (FBM) on the ROA. Barontini and Caprio (2006) found a positive correlation between family board members and ROA based on 2SLS. Firms with family board members are more efficient than other firms, carry less debt, and have better performance (McConaugby et al., 2001).

In terms of non-financial firm ownership (NFINOWN), the researcher found that non-financial firm ownership has a positive effect on ROA with significant at 10 % level. Gorton and Schmid (2000) argued that outside block shareholders play a vital role in monitoring management because the large size of the portion of stock share of outside shareholders gave them more incentive to oversee management and enhance firm performance and work quality. This result is inconsistent with some of previous studies that use the 2SLS. Ntim (2009) found a negative relationship between ROA and block shareholding when he used a sample of 100 South African listed firms from 2002 to 2006. In contrast, our results are consistent with Ben-Amar and Andre (2006) who found that the relationship between outside blockholders and firm performance was positive and significant at a 1% level of a sample of 327 Canadian firms for the period 1998-2002. Our results are consistent with Filatotchev et al. (2005) who found a positive relationship between corporate ownership and ROA among 228 firms listed on the Taiwan Stock Exchange based on the 2SLS regression.

According to Tobin's Q, this study did not find any significant relationship between board characteristics and firm performance. Because the Saudi capital market is an emerging market, this leads to insignificant results for the board structure with the firm valuation (Tobin's Q), and improvement of board structure mechanisms are needed in order to generate good, significant results that may have a positive effect on governance and market value. Various board structure variables (board size, non-executive members, family board members, royal family board members, board committees) are not significant in the Tobin's Q regression. There may not be much variation in practice in the independent variables. This could be the case if Saudi listed companies comply in form with the corporate governance codes, and their board structures are more or less the same (little variation in board size, non-executive members, family board members, royal family board members, board committees). However, this is probably not convincing reason, because lack of variation in board structure variables would also lead to insignificant as regard ROA.

Return on assets (ROA) is backward-looking, while Tobin's Q is forward-looking and is based on investors' expectations. It is quite consistent for investors to believe that board structure does not matter to future performance maybe because the investors think that the board of directors are not an important aspect of corporate decision-making governance, while in practice it does make a different to performance. The actual effect on performance would show up in ROA, but the investors' belief that board structure is irrelevant would lead to no statistically significant in Tobin's Q.

In terms of government ownership (GOVOWN), for the results like the ROA, the coefficient on the Tobin's Q is positive and statically significant at 1%. This means that firms with a high percentage of government ownership will receive a high market value. This result is inconsistent with Mak and Li (2001). They found that the relationship between government ownership and firm value is negative. In addition, Wei and Varela (2003) found a negative relationship between government ownership and Tobin's Q in China; however, when the researchers took the square of government ownership, they found a positive relationship with Tobin's Q.

Regarding foreign ownership (FOROWN), this study found a highly positive, significant relationship between foreign ownership and Tobin's Q. The existence of foreign ownership in Saudi listed companies leads to an increase market valuation (Tobin's Q). With this type of ownership, firm value is improved by inviting some of foreign members to sit on the board of directors to increase efficiency and improve the market valuation of the Saudi capital market, especially if this member is from a developed country. Moreover, foreign investors often play more of a role in prompting changes in corporate governance practices than domestic investors (Baert and Vennet, 2009).

With reference to the results for non-financial firm ownership (NFINOWN), the analysis suggests that a higher percentage of non-financial firm ownership leads to increased firm value (Tobin's Q). This study found the relationship between non-financial firm ownership and Tobin's Q to be positively significant at a 1% level. Filatotchev et al. (2005) found a positive relationship between corporate ownership and firm performance among 228 firms listed on the Taiwan Stock Exchange based on the 2SLS regression.

7.7 THE EFFECT OF CORPORATE GOVERNANCE MECHANISMS BETWEEN EACH OTHER USING TWO STAGES LEAST SQUARE (2SLS)

This study considers the causality issue between all corporate governance mechanisms and uses firm performance as independent variables. This study not only focuses on the effect of the mechanisms of corporate governance on firm performance, but also seeks to examine the impact of firm performance (ROA and Tobin's Q) on corporate governance mechanisms. The following tables report the results of the 2SLS that examined the effect of corporate governance mechanisms with each other and with firm performance.

According to ROA, the regression of the board size (BSIZE), the 2SLS found that the firm performance of ROA has a positive significant effect on board size at 5%, which means the same effect on the board size and on the ROA (positive effect on both sides). The researcher found the non-executive board member, family board member, and royal family board member have a positive effect on the board size with a significance of 1%, 5%, and 5%, respectively, which means that a larger board size is associated with more members of other types of board members such as non-executive, family, and royal family board members. In addition, the relationship between board size and the managerial ownership is positive at the 10% level. However, the 2SLS suggested that board size is statistically significant with a lower percentage of family ownership and government ownership. In addition, this study found that the smaller board is associated with a higher percentage of non-financial firm ownership. Firm size is found to be highly positively significant with board size ($p > 0.01$).

For the number of the non-executive members (NEXE), the 2SLS found the ROA has an insignificant effect on the number of the non-executive members. Both financial ownership and non-financial firm ownership are statistically significant and positively associated with the number of the non-executive members. The results showed that the number of non-executive members increases with increasing financial and non-financial firm ownership, larger board size, and lower family ownership. Firm size is found to have a highly positively significant effect on the non-executive members. The statistically significant and positive coefficient between the industry types and non-executives indicates that the industry types have a significant influence on selecting the number and the quality of the non-executives who have specific knowledge and experience in the business activities.

This study found that the statistically significant positive effect of the ROA on the family board members (FBM) was 1%. That means firms with more family board members do not only enhance ROA, but there is a reverse relationship, which mean firms with a high ROA effect have good family members who have experience and more responsibility about the firms. The results showed that both the board size and board committees are statistically significant and positively related with family board members at 1% level. With regard to ownership structure, this study found that family board members increase with increasing managerial ownership and non-financial firms' ownership and decreasing government ownership and foreign ownership. These findings are related to the ownership structure and indicate that government ownership and foreign ownership prefer to appoint members from outside the family, whereas the majority of managerial ownership and the number of non-financial firm ownership (block ownership) are representative of family or individual companies in Saudi Arabia. Royal family board members are positively related with family board members at the 1% level. This study found that one of the industry types (IND 4) in the investment industry has a significant positive effect on the family board members.

With regard to the findings for board committees (BCOM), the results showed that the coefficient of the ROA is zero, which means there is no relationship between board committees and ROA, and firm performance does not have any effect on the board committees. However, the results indicated that family board members and royal family board members are statistically significant and positively associated with board committees. In contrast, the 2SLS found an insignificant relationship between board committees and ownership structure, except for financial firms' ownership, which is high positive significance on the board committees.

With reference to the results for managerial ownership (MANOWN), they showed that a higher ROA led to a higher percentage of managerial ownership. This result suggests that more profitable firms need to be dominated and monitored by managerial ownership. In addition, a greater family ownership and increasing number of family board members and royal family board members are statistically significant and associated with managerial ownership. In contrast, government ownership and financial firm ownership have a negative effect on managerial ownership.

The findings for family or individual ownership (FAMOWN) indicated that the non-executive board members are highly significant with negative signs on the family or individual ownership, which means that a high number of non-executive board members is associated with lower family ownership of the firms. There is a statistically significant and positive reverse association between managerial ownership and family or individual ownership. The unexpected result was that the firm performance (ROA) has a negative effect on family or individual ownership. Foreign ownership is statistically significant and negatively related to the family or individual ownership. However, financial firm ownership was found to be highly positively significant (1% level) with family or individual ownership. This result indicates that there is a complementarily relationship between family ownership and financial firms' ownership. There is a positive relationship with high statistical significance between manufacturing industries and family or individual ownership.

This study found that the positive effect of the ROA on the government ownership (GOVOWN) was statistically significant at 1%. There is a reverse relationship between ROA and government ownership. However, the 2SLS found that government ownership increases with decreasing managerial ownership, foreign ownership and non-financial firms' ownership with smaller numbers of board members and smaller numbers of family members sitting on the board. Firm size is found to be highly positively significant with government ownership ($p > 0.01$), and this finding indicated that government ownership concerned the larger firms. This study found a highly positive significance between manufacturing firms and government ownership.

The findings for foreign ownership (FOROWN) indicated that the family board members are highly significant with negative signs on foreign ownership, which means that the existence of family board members leads to a decrease in the foreign ownership of the firms. In addition, foreign ownership increases with decreasing family ownership and government ownership. Firm size has a high positive significance with foreign ownership at 1% level. This finding indicated that foreign ownership prefers to invest in the larger firms. This study also found a highly positive significance between manufacturing firms and investment firms listed in the Saudi capital markets with foreign ownership. This finding indicates that the foreign ownership seeks to invest money into manufacturing (petrochemical companies) and investment firms listed on the Saudi capital markets.

With regard to the findings for financial firm ownership (FINOWN), the ROA has an insignificant effect on the financial firm ownership. Increasing the non-executive members on the board leads to an increase in the percentage of the financial firm ownership. Financial firm ownership increases with decreasing managerial ownership and non-financial firm ownership and increasing family or individual ownership. Board committees have a positive significant effect on the financial firm ownership, which means there is a reverse relationship between financial firm ownership and board committees. The industry types have a significant negative effect on the financial firm ownership.

The findings for non-financial firm ownership (NFINOWN) were statistically significant at 10% and positive for non-financial firm ownership-ROA relationship, and there is a reverse association between the ROA and non-financial firm ownership. Non-financial firm ownership increases with a decreasing board size and the board size becomes more focussed on the non-executive members. There is an opposite relationship between government ownership and financial ownership with non-financial firm ownership. Firm size is found to be highly positively significant with non-financial firm ownership at 1% level. This finding indicated that non-financial firm ownership prefers to invest in the larger firms.

This study found that the positive effect of the ROA on the royal family board members (RFBM) was statistically significant at 1%. Royal family board members increase with an increasing board size and board size becomes less focussed on the family board members. The managerial ownership has a positively significant effect on the family board members. Royal family board members and managerial ownership seem to be complements. Royal family board members increase with decreasing family or individual ownership.

According to Tobin's Q, the regression of the board size (BSIZE), the 2SLS found the Tobin's Q has an insignificant effect on board size. The researcher found the non-executive board members, family board members, and royal family board members have a positive effect on the board size and are significant at 1%, 1%, and 5%, respectively, which means that larger board size is associated with more members of different types such as non-executive, family, and royal family board members. Board size increases with increasing managerial ownership and decreasing family ownership and non-financial firms' ownership. Firm size is found to be highly positively significant with board size at 1% level.

Regarding non-executive members (NEXE), the direction of the relationship between non-executive members and board size is positive, and the board size has a highly positive and significant effect on the non-executive members. The results suggested a lower percentage of family or individual ownership, but greater financial and non-financial firm ownership is statistically significant with non-executive board members. The statistically significant and positive coefficient between the industry types and non-executive members indicate that the industry types have a significant influence on selecting the expertise of non-executive members who have specific knowledge and experience in the business activities. Also, firm size has positive significance at a 5% effect on the non-executive members.

The findings for family board members (FBM) suggested that family board members increase with increasing managerial ownership and non-financial firms ownership and decreasing foreign ownership. These findings indicated that most of the managerial ownership is representative of a family business in which they owned shares in the firms and nominated board members to sit on the board of directors of the firms. In contrast, government ownership and foreign ownership seek to prevent family members from sitting on the board of directors. The result suggested that royal family board members are statistically significant at 1% level with a negative sign effect on the family board members.

With regard to the findings for board committees (BCOM), the results indicated that family board members and royal family board members are statistically significant and positively associated with board committees at 1%. In contrast, the 2SLS found an insignificant relationship between board committees and ownership structure except for financial firm ownership, and it has highly positive significance on the board committees.

With reference to the results for managerial ownership (MANOWN), increasing family ownership led to increased managerial ownership. However, managerial ownership increases with decreasing government ownership and financial firms' ownership. Both family board members and royal family board members have a positive effect on the managerial ownership.

The findings for family or individual ownership (FAMOWN) indicated that the non-executive board members have a highly significant effect with a negative sign on the family or individual ownership, which means that an increase in the non-executive board members leads to a decrease in the family ownership in the firms and family ownership prefers to decrease the number of the non-executive members and nominate family members to the boards. There is a statistically significant and positive reverse association between managerial ownership and family or individual ownership. There is a highly significant at 1% level with positive effect of financial firms ownership on the family or individual ownership. This implies that family ownership is more like to invest in firms with a high percentage of the financial firms' ownership to receive more funds. In contrast, foreign ownership has a highly statistically negative effect on family or individual ownership.

With respect to the findings for government ownership (GOVOWN), this study found that the statistically significant positive effect of Tobin's Q on the government ownership at 1%.

Relating to the government ownership, the direction of the most relationship is negative between other ownership structures and board of directors with the government ownership. For example, the non-financial firm ownership and foreign ownership have a highly negative statistic with 1% on the government ownership. The 2SLS found that the managerial ownership has a negative effect on the government ownership at the 10% level, which means these three types of the ownership are working to prevent and reduce the government ownership in the firms.

As for the findings for foreign ownership (FOROWN), this study found that the statistically significant positive effect of Tobin's Q on the foreign ownership at 1%. Family or individual ownership and government ownership work together to reduce and prevent the foreign ownership from owning shares in the Saudi capital market. The control variables (firm size and industry types) have a positive effect on the foreign ownership. Foreign ownership increases with increasing financial firms' ownership (significant at 10%) and decreasing royal family board members and non-financial firm ownership but it is not significant. High Tobin's Q attracts investors which leads to high Tobin's Q in future. Also, high Tobin's Q implying good growth performance so attracts foreign ownership, but this has effect on share price leading to bigger market value and higher Tobin's Q.

With regard to the findings for financial firm ownership (FINOWN), the Tobin's Q has an insignificant effect on the financial firm ownership. Increasing the non-executive members on the board increases the percentage of the financial firm ownership. Financial firm ownership increases with decreasing managerial ownership and non-financial firm ownership and increasing family or individual ownership. Board committees have a positive significant effect on the financial firm ownership, which mean there is a reverse relationship between financial firm ownership and board committees. The industry types (manufacturing, services, food and investment) have a significant negative effect on the financial firm ownership.

The findings for non-financial firm ownership (NFINOWN) are statistically significant at 1% and positive for the non-financial firm ownership-Tobin's Q relationship. There is a reverse association between the Tobin's Q and non-financial firm ownership. Non-financial firm ownership increases with a decreasing board size and non-financial firm ownership prefers that the board size becomes more focussed on the non-executive members, which means the non-financial firm ownership prefers a smaller board size and that the majority of the board member become non-executive members. There is an opposite relationship between government ownership and financial ownership with non-financial firm ownership, and these two types of the ownership seek to reduce the non-financial firm ownership in the firms. Firm size is found to have a highly positive significance with non-financial firm ownership at 1% level. This finding indicated that non-financial firm ownership prefers to invest in the larger firms.

This study found that the statistically significant positive effect of the Tobin's Q on the royal family board members (RFBM) was 10%. Royal family board members increase with an increasing board size and with less focus on the family board members. Royal family board members increase with an increasing managerial ownership and decreasing family or individual ownership. Royal family board members and managerial ownership seem to be complements.

Table 7-7 2SLS Regression Using Corporate Governance Mechanisms as Dependent Variables with ROA

Indep. Variables	Dependent variables										
	BSIZE	NEXE	FBM	BCOM	MANOWN	FAMOWN	GOVOWN	FOROWN	FINOWN	NFINOWN	RFBM
Constant	3.591 ***	-4.560 ***	-1.061	0.018	-6.895	-0.604	-72.9 ***	-24.03 ***	0.850	-15.843	0.129
BSIZE		0.519 ***	0.136 ***	0.004	0.409	-0.445	-1.117 *	0.123	0.004	-2.261 ***	0.037 **
NEXE	0.197 ***		-0.035	-0.017	0.113	-0.564 ***	0.044	0.004	0.137 ***	1.621 ***	-0.007
FBM	0.179 **	-0.106		0.085 ***	0.682 **	0.182	-1.369 **	-0.723 ***	0.018	1.562 *	-0.076 ***
BCOM	0.085	-0.621	0.730 ***		-1.637 *	-0.993	-1.308	0.373	0.942 ***	1.041	0.236 ***
MANOWN	0.024 *	0.031	0.039 ***	-0.006		0.927 ***	-0.328 **	0.081	-0.066 ***	0.022	0.018 ***
FAMOWN	-0.028 **	-0.063 **	0.007	-0.002	0.852 ***		0.096	-0.129 **	0.085 ***	-0.124	-0.007 *
GOVOWN	-0.098 *	0.001	-0.009 **	-0.001	-0.064 **	0.017		-0.133 ***	-0.005	-0.519 ***	0.002
FOROWN	0.004	-0.004	-0.033 ***	0.001	0.091	-0.217 ***	-0.835 ***		0.019	-0.144	0.001
FINOWN	0.090	0.532 ***	0.108	0.147 ***	-1.203 ***	2.571 ***	-0.837	0.503 *		-5.71 ***	-0.026
NFINOWN	-0.010 **	0.024 ***	0.006 *	0.001	-0.006	0.013	-0.3 ***	-0.013	-0.017 ***		-0.001
RFBM	0.361 *	-0.131	-0.608 ***	0.226 ***	3.441 ***	-1.127	2.232	0.237	-0.135	-3.37	
ROA	0.018 **	-0.021	0.017 ***	0	0.099 **	-0.073 *	0.250 ***	-0.041	0.006	0.187 *	0.005 **
IND1	0.398	1.564 ***	0.092	0.133	-1.092	3.4 ***	8.295 ***	3.453 ***	-1.026 ***	-5.578 *	0.015
IND2	-0.063	1.184 **	0.215	0.045	-4.175 ***	6.32	0.834	1.522	-1.251 ***	-9.451 ***	0.075
IND3	0.027	1.665 ***	0.080	0.214 **	0.880	2.18 *	-0.339	1.339	-1.157 ***	-12.849 ***	-0.114 *
IND4	-0.685 *	1.449 **	1.538 ***	-0.068	1.587	1.62	4.718	4.257 ***	-0.853 *	-15.857 ***	-0.231 **
FSIZE	0.252 ***	0.296 **	0.015	0.022	0.223	0.487	6.677 ***	1.772 ***	-0.071	3.617 ***	-0.022
R^2	0.282	0.249	0.513	0.163	0.845	0.834	0.523	0.286	0.206	0.344	0.223
Adj. R^2	0.249	0.213	0.490	0.123	0.837	0.826	0.5	0.252	0.169	0.313	0.186
F-value	8.33 ***	7.02 ***	22.27 ***	4.13 ***	115.26 ***	106.28 ***	23.17 ***	8.48 ***	5.51 ***	11.08 ***	6.08 ***

Table 7-8 2SLS Regression Using Corporate Governance Mechanisms as Dependent Variables with Tobin's Q

Indep. Variables	Dependent variables										
	BSIZE	NEXE	FBM	BCOM	MANOWN	FAMOWN	GOVOWN	FOROWN	FINOWN	NFINOWN	RFBM
Constant	3.79 ***	-3.844 **	-1.188	0.099	-6.937	-1.723	-94.735 ***	-29.567 ***	0.429	-35.85 ***	-0.138
BSIZE		0.506 ***	0.154 ***	0.004	0.495	-0.508	-0.853	0.09	0.01	-2.054 ***	0.042 **
NEXE	0.191 ***		-0.044	0.018	0.067	-0.529 ***	-0.002	0.039	0.135 ***	1.554 ***	-0.01
FBM	0.203 ***	-0.127		0.084 ***	0.802 **	0.104	-1.69 *	-0.768 ***	0.024	1.672 *	-0.071 ***
BCOM	0.067	-0.599	0.725 ***		-1.775 *	-0.915	-1.1524	0.397	0.933 ***	0.768	0.231 ***
MANOWN	0.027 **	0.027	0.043 ***	-0.006		0.924 ***	-0.244 *	0.078	-0.065 ***	0.068	0.019 ***
FAMOWN	-0.031 **	-0.059 **	0.005	-0.002	0.851 ***		0.019	-0.127 **	0.083 ***	-0.174	-0.008 **
GOVOWN	-0.007	0.001	-0.008	-0.001	-0.054 *	0.005		-0.155 ***	-0.006	-0.555 ***	0.001
FOROWN	0.002	0.002	-0.037 ***	0.001	0.079	-0.213 ***	-0.937 ***		0.016	-0.255	-0.001
FINOWN	0.086	0.538 ***	0.105	0.147 ***	-1.239 ***	2.603 ***	-0.823	0.504 *		-5.627 ***	-0.027
NFINOWN	-0.009 **	0.024 ***	0.007 *	0.001	-0.001	0.008	-0.308 ***	-0.023	-0.017 ***		-0.001
RFBM	0.439 **	-0.173	-0.562 ***	0.230 ***	3.845 ***	-1.44	1.741	-0.173	-0.13	-3.566	
Tobin's Q	-0.018	-0.149	0.027	-0.014	0.036	0.174	4.953 ***	1.098 ***	0.08	3.846 ***	0.052 *
IND1	0.0309	1.62 ***	0.019	0.128	-1.557	3.855 ***	8.539 ***	3.966 ***	-1.026 ***	-4.9 *	0.01
IND2	-0.136	1.287 ***	0.146	0.046	-4.627 ***	6.637 ***	-0.57	1.538 *	-1.283 ***	-10.326 ***	0.05
IND3	-0.083	1.737 ***	-0.007	0.208 **	0.363	2.660 **	0.331	1.961 **	-1.16 ***	-12.088 ***	-0.125 *
IND4	-0.697 **	1.517 **	1.551 ***	-0.063	1.569	1.589	2.68	3.805 ***	-0.881 **	-16.914 ***	-0.253 ***
FSIZE	0.248 ***	0.260 **	0.020	0.018	0.221	0.551	7.627 ***	2.047 ***	-0.048	4.587 ***	-0.008
R^2	0.272	0.246	0.503	0.164	0.842	0.832	0.55	0.301	0.206	0.357	0.217
Adj. R^2	0.237	0.210	0.479	0.124	0.834	0.824	0.52	0.268	0.169	0.326	0.180
F-value	7.89 ***	6.90 ***	21.39 ***	4.14 ***	112.65 ***	105.18 ***	25.83 ***	9.11 ***	5.51 ***	11.73 ***	5.87 ***

7.8 THE DYNAMIC GENERALIZED METHOD OF MOMENTS (GMM)

This approach was proposed by Lars Peter Hansen in 1982 (Verbeek, 2004). The GMM procedure is a nonparametric approach to estimating model parameters (Schultz et al., 2010). This model was first introduced by Holtz-Eakin, Newey, and Rosen (1988), and Arellano and Bond (1991), and extended in further papers by Arellano and Bover (1995), and Blundell and Bond (1998) (Bond et al., 2001; Schultz et al., 2010; Wintoki et al., 2012). The model is common in economic and financial studies in which the relation is naturally dynamic between dependent and independent variables, such as modelling paths of convergence for economic growth (Caselli et al., 1996), estimating a labour-demand model (Blundell and Bond, 1998), modelling the relationship between financial-intermediary development and economic growth (Beck et al., 2000), and corporate-governance studies such as corporate governance and likelihood of firm failure (Schultz et al., 2011; Wintoki et al., 2012). To overcome problems of bias, and inconsistent and inefficient estimators using OLS for panel data, it is recommended that a dynamic-GMM-panel model be used to examine the relationship between corporate-governance mechanisms and firm performance (Wintoki et al., 2012), which leads to more reasonable results in this relationship (Bond et al., 2001).

The dynamic-GMM model explores endogeneity usually inherent in independent variables in many economic and finance models, especially in the relationship between corporate-governance mechanisms and firm performance (Schultz et al., 2011; Wintoki et al., 2012). Wintoki et al. (2010) (as cited in Schultz et al., 2010) classify three sources of potential endogeneity in the relationship between corporate governance and firm performance:

1. Dynamic endogeneity: This is present when the current value of a variable is influenced by its value in the preceding time period. This occurs in our study when the current governance structure, control characteristics, and performance of the firm are determined by the firm's past performance.
2. Simultaneity: This is when two variables are co-determined such that each variable may affect the other simultaneously. In the governance-performance relation, the corporate governance variables and control variables may be determined concurrently with the firm's performance.
3. Unobserved heterogeneity: This situation is present when a relation between two or more variables is affected by unobservable factor. In the governance-performance relationship, firm-specific characteristics—the firm-fixed effect—may affect a firm's

governance structure, control characteristics, and performance, but may be unobservable to the researcher and therefore difficult to quantify.

According to Bond et al., (2001) the Generalized Method of Moments (GMM) has important advantages over simple regression and other estimation methods for the dynamic-panel-data models, as a follows:

1. Estimates will no longer be biased by omitted variables that are constant over time.
2. The use of instrumental variables allows parameters to be estimated consistently in models that include endogenous right-hand-side variables.
3. The use of instruments potentially allows consistent estimation even in the presence of measurement error.

The basic idea of the dynamic-GMM approach is to write the regression equation as a dynamic panel data model and take the first differences to remove unobserved time-invariance and country-specific effects (unobserved heterogeneity) (Bond et al., 2001). After that, estimate GMM using lagged values of independent variables as instruments for the included independent variables in the model (Wintoki et al., 2012). Thus, the past value of corporate-governance mechanisms, control variables used in our case as instruments for the present changes, can be concluded here so that the model actually uses the firm's history as instruments for the model's included independent variables. The relationship between corporate governance mechanisms and firm performance is estimated in functional form, as given in the model developed by Wintoki et al. (2012):

$$y_{it} = \alpha + \sum_s \kappa_s y_{it-s} + \beta X_{it} + \gamma Z_{it} + \eta_i + \varepsilon_{it} \qquad s = 1, \dots, p, \quad (1)$$

where y, X and Z represent firm performance, corporate governance variables, and firm specific attributes, while η is the unobserved firm's specific attributes resulting in the model's estimation having problems not possible to counter using traditional methods like ordinary least square and fixed effects regression for panel data. The above regression is conditioned on firm heterogeneity. In the above model, $\varepsilon_{it}$is a random-error term and β is the effect of corporate governance variables on the firm's performance. The model is actually estimated in two steps. It can be written in the following dynamic model equation (2):

$$\Delta y_{it} = \alpha + \kappa_p \sum_p \Delta y_{it-p} + \beta \Delta X_{it} + \gamma \Delta Z_{it} + \Delta \varepsilon_{it}\,, \qquad p > 0 \qquad (2)$$

The first difference is that the above equation (2) will eliminate any bias potentially available due to the unobserved heterogeneity. The important aspect of the dynamic model estimator is its use of the of the firm's history as instruments for our independent variables (Wintoki et al., 2012). Estimating equation (1) using the first-difference transformation to equation (2), the instruments used in the model are a set of the lagged value of dependent or independent variables.

According to Wintoki et al. (2012), the instrument's validity is tested using two criteria, as follows:

First, the instruments should provide a source of variation for the present values of the independent variables (corporate governance variables).

Second, the lagged value should also provide an extraneous source of variation in the corporate governance variables as included in the list of independent variables in the model. The assumption when including these lagged values in dynamic GMM models is to have a zero-correlation coefficient between the lagged independent variables and the error terms of the equations of dependent variables such as firm performance.

Corporate governance variables for organizations observed in this study usually trade off pros and cons of specific corporate governance systems; the change in the firm's performance was unanticipated at the time the corporate governance system was taken into account (Wintoki et al., 2012). Hence, the system shows information from a firm's past, observed in its performance within a specific time period, say "p" time period. The inclusion of p lags behind the dependent variables (firm performance) in the model, it will sufficiently capture the effects of the firm's history. The lags confirm the dynamic completeness of the system as defined in equation 1. Keeping this in mind, it is assumed that any piece of information from the history of the specific firm has no effect on its present performance following the current corporate governance and the firm's specific determinates, hence *t-p* lags behind time history and can be considered as exogenous as it has no contribution to changes in the current or future time periods (Wintoki et al., 2012). This is usually confirmed following validity testing.

According to Wintoki et al. (2012), if the above assumptions related to the exogeneity of the instruments' validity holds, the condition on the orthogonality of the system can be written as:

$$E(X_{it-s}\varepsilon_{it}) = E(Z_{it-s}\varepsilon_{it}) = E(y_{it-s}\varepsilon_{it}) = 0, \quad \forall s > p \qquad (3)$$

Equation 2 is estimated using GMM given the orthogonality conditions listed above, despite three limitations identified in the following lines. But due to its econometrics appeal, this approach is highly appreciated in empirical literature (Wintoki et al., 2012). As cited in Wintoki et al. (2012), Beck et al., (2000) point out that if the model under consideration is in level, the difference will produce a lower power for the testing. Secondly, Arellano and Bover (1995) argue that level variables are weak instruments to use in a differenced-system of equations. Lastly, Griliches and Hausman (1986) conclude that differencing increases the effect of measurement errors on the dependent variables. However, Arellano and Bover (1995), and Blundell and Bond (1998), improved the system of GMM by including level equations in estimating techniques so the instruments can be defined from the first differences and included in equations in levels as a stacked system that contains equations in both levels and differences (as cited in Schultz et al., 2011; Wintoki et al., 2012).

In the above, the system GMM estimation model involves the following:

$$\begin{bmatrix} y_{it} \\ \Delta y_{it} \end{bmatrix} = \alpha + \kappa \begin{bmatrix} y_{it-p} \\ \Delta y_{it-p} \end{bmatrix} + \beta \begin{bmatrix} X_{it} \\ \Delta X_{it} \end{bmatrix} + \gamma \begin{bmatrix} Z_{it} \\ \Delta \mathrm{Z}_{it} \end{bmatrix} + \varepsilon_{it} \qquad (4)$$

The above system contains levels that further contain unobserved heterogeneity. It can be assumed that corporate governance and control variables might be related to the unobserved effects, but will remain constant over the sample time period, which is considerably smaller (Schultz et al., 2011; Wintoki et al., 2012). It further leads to orthogonality conditions given by:

$$E[\Delta X_{it-s}(\eta_i + \varepsilon_{it})] = E[\Delta Z_{it-s}(\eta_i + \varepsilon_{it})] = E[\Delta y_{it-s}(\eta_i + \varepsilon_{it})] = 0 \quad \forall s > p \qquad (5)$$

As in the above conditions, the GMM provides efficient estimates while controlling the unobserved heterogeneity, dynamic endogeneity, and simultaneity and the dynamic relationships (Wintoki et al. 2012) between the present values of the independent variables (corporate governance mechanisms) and the past values of the dependent variables (ROA and Tobin's Q).

Using panel data and GMM estimation under the assumptions of the orthogonality conditions (3) and (5) assuming no serial correlations in the residuals of the regression model, ε (Wintoki et al. 2012). Conditions (3) and (5) imply using, respectively, the lagged levels as instruments for the system of differenced equations, and lagged differences as instruments for the system of level equations. Afterwards, the assumptions of orthogonality conditions are tested rigorously alongside the instruments' strength, based on the assumptions above.

The main assumptions of the exogeneity are that the firm's performance in the past, and other attributes, are exogenous as related to the deviations and impulses in the performance in the present. Wintoki et al. (2012) report that there are two main test procedures suggested by Arellano and Bond (1991):

- The first test is based on testing a serial correlation at the second order, mainly due to concerns related to including enough lags into the model. If such lags are included, then any lag above that length will be exogenous and can be included as a valid instrument exogenous to the impulses in the firm's performance. In setting up the GMM estimation, the validity of specification assumptions gives the residuals their first differences and will be correlated at the second order.
- The second is related to testing of over identification and is commonly known in the literature as the Hansen test or Hansen J-statistic. In case of panel-dynamic GMM, when multiple lags are used as instruments it is commonly the case that the system becomes over identified. The J-statistic is a χ^2 under the null of validity for the instruments.

7.9 THE RELATIONSHIP BETWEEN FIRM PERFORMANCE AND CORPORATE GOVERNANCE MECHANISMS BASED ON GMM

In this section, we proceed to apply the Dynamic GMM model to examine the relationship between corporate governance mechanisms and firm performance. According to Wintoki et al. (2012), it is important to understand how many lags of dependent variables (ROA and Tobin's Q) are needed to capture all information from the past performance. This is important for two reasons: first, failure to capture all influences of the previous performance on the current could still mean that is mis-specified, which may cause an omitted variable bias;

second, it can be argued that all older lags are exogenous with respect to the residuals of the present, which can be used as instruments. A number of previous studies—e.g., Glen et al. (2001), Gshwandtner (2005), and Wintoki et al. (2012)—suggest that using two lags of dependent variables is more effective in capturing the persistence of profitability. In the presence of endogeneity, the OLS estimation will produce biased and inappropriate parameter estimates, while this study uses the Dynamic GMM approach to get more accurate and consistent outcomes. The Dynamic GMM approach examines the relationship between corporate governance and firm performance, including the past performance, to control the problem of time-invariant and unobserved heterogeneity (Wintoki et al., 2012). Table (7-9) below contains Dynamic GMM regression results based on the return on assets (ROA) and Tobin's Q.

7.9.1 RESULTS OF THE DYNAMIC GMM BASED ON ROA

This study provides the results of two models for each performance indicator—the first model with a one-year lag of performance and the second model with a two-year lag of performance. With reference to the board size (BSIZE), the coefficient is positively significant with two models (lag 1 and lag 2 of ROA). This result is in contrast with that of Conyon and Peck (1998), who used dynamic GMM estimation and found that board size appears inversely related to firm performance. Schultz et al. (2010) used the Dynamic GMM estimation and found a positive relationship between board size and firm performance, but it was insignificant. However, our finding is associated with those of Sanda et al. (2005) and Haniffa and Hudaib (2006). In addition, Kama and Chuku (2009) used Dynamic GMM and found a positive relationship between board size and ROA. Our result in the same line of the OLS and 2SLS showed the coefficient on board size is significantly positive (OLS = 0.578 ***, 2SLS = 0.806 *). In addition, this result of the Dynamic GMM does not change with the past ROA for one year or two years, indicating that the dynamic is associated with the static model.

With regard to a non-executive board member (NEXE), the GMM suggested that there is a negative relationship between a non-executive and ROA. Wintoki et al. (2012) applied the Dynamic GMM and found a negative relationship between board independence (non-executive) and ROA, but it was insignificant. Ntim (2009) found a negative relationship between a non-executive and ROA when he lagged the financial performance; he found the same result for the non-executive members as we did. Hermalin and Weisbash (1998) explained this situation by suggesting that managers who have a strong ability of monitoring have less intently by shareholders, which leads to less independence (as cited in Wintoki et al., 2012) and to a negative effect on ROA. This result is supported by stewardship theory, which indicates that non-executive members have less knowledge and experience, which leads to poor performance (Weir and Laing, 2000; Ntim, 2009). This result indicated a negative relationship even when the past performance was controlled.

A statistically significant positive relationship between family board member (FBM) and ROA was found with two models. This result was in the same line as those of OLS and 2SLS, which find a positive relationship with ROA. This result is associated with previous studies (McConaugby et al., 2001; Maury, 2006; Sandra et al., 2008; Amran and Ahmad, 2010). Miller et al. (2013) argued that firms run by family board members (executives or non-executives) who often associated with their business closely had useful information and knowledge about their businesses, which led to enhanced firm performance compared to firms that do not have family board members. In contrast, royal family board members were found to be negatively significant on the ROA with two-year lags.

Regarding board sub-committees (BCOM), the Dynamic GMM found a positive highly significant relationship between board sub-committees and ROA when controlling for the lags of ROA. However, the static OLS estimate found an insignificant negative relationship between board sub-committees and ROA. The sign flip (from negative to positive) with respect to the effect of board sub-committees on ROA is interesting and explains the bias that may arise from ignoring the unobservable heterogeneity and dynamic related with past performance. This study result is associated with that of Laing and Weir (1999), who found a positive relationship between board sub-committees and ROA.

The Dynamic GMM found a statistically significant and positive effect of managerial ownership (MANOWN) on ROA. Our result is consistent with convergence-of-interest. Miguel et al. (2004) found a positive relationship between managerial ownership and firm performance with Dynamic GMM estimation. This result is consistent with those of Owusu-Ansah (1998), Mangena and Tauringana (2008), and Kapopoulos and Lazaretou (2007), who found a positive relationship between ROA and managerial ownership. Also, our result was along the same line as that of Park and Jang (2010), who examined the relationship between firm performance and managerial ownership using various techniques such as OLS, 2SLS, and GMM, and found a positive relationship between managerial ownership and firm performance. Our study found a strong relationship between managerial ownership and ROA under the control of endogeneity with one and two previous performances.

On the other hand, the results based on the Dynamic GMM suggested that the family or individual ownership (FAMOWN) has a highly significant effect on ROA. This result did not change with the Dynamic GMM and with control endogeneity with lags of ROA. This finding indicated poor legal investor protection in some developing countries (Omran et al., 2008). Omran et al. (2008) found that the family or individual ownership has a negative and significant impact on firm performance. This result indicates that family ownership interest appears to expropriate the minority shareholders, which means the family looks after its own interests to such an extent that residual profits available for minority shareholders are limited (La Porta et al., 1999; Shyu, 2011). Kowalewski et al. (2010) took into account the endogeneity of family ownership and found a positive relationship between family ownership and ROA under the Dynamic GMM estimation.

With respect to government ownership (GOVOWN), the Dynamic GMM found the same result as that of OLS. The results show that the government ownership has a highly positive significant effect on ROA. This finding is along the same line as those of Sun et al. (2002) and Omran et al. (2008), who examined the relationship between government ownership and firm performance and found a positive relationship.

Foreign ownership (FOROWN) was found to be highly negative and significant on the ROA. Empirically, this result supports the result of Lehmann and Weigand (2000) and OLS results, even with controlled endogeneity. Also, Al-Shiab and Abu-Tapanjeh (2005) found a negative relationship between foreign ownership and ROA among one of the Arab countries (Jordan). Our results indicated that the Saudi Arabian stock market does not seem ready to receive foreign investment. Moreover, this result indicates that Saudi companies seek to get support from government to contribute to the infrastructure, and after that in the next stage seek to attract foreign investment.

With respect to financial firms ownership (FINOWN), the Dynamic GMM found a statistically negative relationship between financial firms ownership and ROA. Interestingly, when we estimate the static OLS, we find an insignificant effect; however, in the dynamic GMM the relationship between financial firms ownership and ROA is highly significant. This situation illustrates the bias that may arise from ignoring the dynamic relationship between financial firms ownership and past ROA and unobserved heterogeneity. This finding is along the same line as the finding of Morck et al. (2000) and Lin et al. (2009), who found that the bank ownership hurt firm performance. Actually, our results support the argument of Lin et al. (2009), who argued that financial firms ownership (bank) destroys company performance due to inefficient borrowing and investment policies.

In addition, the results based on the dynamic GMM show that the non-financial firms ownership (NFINOWN) has a statistically significant effect with negative sign on ROA. Interestingly, when we estimated the static OLS, we found a highly positive significant effect; however, in the dynamic GMM the relationship between non-financial firms ownership and ROA is highly negative and significant. This dramatic sign flip illustrates the bias that may arise from ignoring the dynamic relationship between financial firms ownership and past ROA and unobserved heterogeneity. Pham et al. (2011) used GMM and found a negative relationship between firm performance and non-financial firms ownership, but it was insignificant. Other literature has found a negative relationship between large ownership and firm performance, such as Lasfer (2002) and Davies et al. (2005). Moreover, Mura (2007) used GMM as a methodology permitting simultaneous control for endogeneity of the independent variable, and he found a negative relationship between non-financial ownership and firm performance.

With regard to royal family board members (RFBM), the dynamic GMM was found to be insignificant with one lag; however, Glen et al. (2001) and Gschwandtner (2005) suggest that two lags is the standard for capturing the persistence of profitability (as cited in Wintoki et al., 2012). For that purpose, the current study applied two lags, and we found the coefficient on the royal family board members to be negative with significance at 5%. The reason behind the dramatic sign flip (from positive to negative) on the coefficient on the royal family board members is an interesting one and illustrates the bias that may arise from ignoring both unobservable heterogeneity and the dynamic relationship between royal family board members and past firm performance.

With respect to the control variables—firm size and industry types—this study found, after controlling for endogeneity with the dynamic GMM, a positive and significant relationship between firm size and ROA. Interestingly, the static OLS estimate found a negative relationship between firm size and ROA. The sign flip (from negative to positive) with respect to the effect of firm size on ROA is interesting and explains the bias that may arise from ignoring the unobservable heterogeneity and the dynamic related to past performance. The current study is consistent with Wintoki et al. (2012), who found a highly positive significant relationship between firm size and performance under the GMM technique. However, the industry types were found to be negative, except the investments industry, which was found to be positively related to ROA.

7.9.2 RESULTS OF THE DYNAMIC GMM BASED ON TOBIN'S Q

This study provides the results of two models for market value indicator (Tobin's Q)—the first model with a one-year lag of performance and the second model with a two-year lag of Tobin's Q. With regard to board size (BSIZE), the dynamic GMM found the coefficient on the board size to be very weak and to have an insignificant effect on Tobin's Q. This result is consistent with OLS, and this insignificant result indicates that the investors believed that the board size does not matter for future performance, possibly because the investors think that board size is not an important aspect of corporate decision-making governance, and their concern is for the quality not quantity, while in practice it does make a difference for performance. The actual effect on performance would show up in ROA, but the investors' belief that board size is irrelevant would lead to no statistical significance in Tobin's Q. To conclude: Either investors are correct in their belief about the future, even though in practice they have been incorrect in the past; as board size become less varied and converges with the corporate governance code's model, board size will have less of an impact on ROA. Or investors are incorrect in their belief about the future, and board size could potentially add value. In that case, we would expect board size to become statistically significant for Tobin's Q if the analysis were replicated, for example, in five years' time, or if more lags (three or four) were applied. It also supports past evidence that documents an insignificant relationship between board size and firm performance, such as Pham et al. (2011) and Wintoki et al. (2012), who found an insignificant relationship between board size and performance under the GMM technique.

In contrast to ROA, the coefficient on the non-executive members (NEXE) is positive, but the coefficient of the non-executive members with one lag is insignificant and very weakly related to Tobin's Q. However, after controlling for endogeneity with two lags of past performance, the result indicates a highly positive significant relationship between non-executive members and Tobin's Q, and it indicates that the dynamic GMM was not consistent with OLS results, which means that the static sign flip (from negative to positive) on the coefficient on non-executive members is explained by the bias that may arise from ignoring both unobservable heterogeneity and the dynamic relationship between non-executive members and past firm performance. The positive and significant results of the relationship between non-executive members and Tobin's Q under the dynamic GMM and with control for two lags is consistent with and supported by Andres and Vallelado (2008). They found a highly significant positive relationship between non-executive members and Tobin's Q with the GMM. Our result supports the agency theory argument, which states that adding non-executive directors with more experience and knowledge to the board of directors will enhance firm performance by reducing agency costs and conflicts of interest between shareholders and management (Andres and Vallelado, 2008).

Again, in contrast to ROA, the coefficient on the family board members (FBM) is negative, but the coefficient on the family board members with one lag is insignificant. However, after controlling for endogeneity with two lags of past performance, the result indicates a highly negative significant relationship between family board members and Tobin's Q. The dynamic GMM was not consistent with OLS results, which means the static sign flip (from positive to negative with high significance at 1%) on the coefficient on family board members is explained by the bias that may arise from ignoring both unobservable heterogeneity and the dynamic relationship between family board members and past firm performance. The negative and significant results reveal that if a company appoints a new family board member to the board of directors, the new member may be expected to exploit the minority shareholders; also, when the family board members grow the board of directors, it may be to seek to remove the good CEO and appoint a CEO from the same family, which may lead to the destruction of the firm performance.

Similar to the results of ROA, the coefficient on the royal family board members (RFBM) is negative with high significance at the 1% level. The dynamic GMM was not consistent with OLS results, which means the static sign flip on the coefficient on royal family board members is explained by the bias that may arise from ignoring both unobservable heterogeneity and the dynamic relationship between royal family board members and past firm performance. The negative and significant results reveal that if a company appoints a new royal family board member to the board of directors, the new member may be expected to exploit the minority shareholders and may seek to remove the good CEO and appoint a CEO from the same family or same related, which may lead to the destruction of the firm performance. Also, the royal family board member may not have enough experience and knowledge to run the company in the best way, and he may make some wrong decisions, leading to stagnated or decreased firm performance.

In contrast to ROA, the coefficient on the board sub-committee (BCOM) is negative with high significance at 1% for Tobin's Q. Also, similar to ROA, the static OLS estimate found an insignificant relationship between board sub-committees and Tobin's. The static flip (from insignificant to significant) with respect to the effect of board sub-committees on Tobin's Q is interesting and explains the bias that may arise from ignoring unobservable heterogeneity and the dynamic related to past performance. Our result indicates that the establishment of board sub-committees may impose extra costs that are held by companies and boards of directors; also, excessive managerial supervision may be produced, duplicating the duties and responsibilities of the board of directors and board sub-committees (Goodstein et al., 1994; Conger et al., 1998; Vafeas 1999; Ntim, 2009). Our result is consistent with that of Vafeas (1999), who noted a negative relationship between board sub-committees and firm value.

Managerial ownership (MANOWN) is found to have a positive significant effect on Tobin's Q after controlling for one lag of performance under the dynamic GMM. Furthermore, when taking two lags of performance, the sign flips from positive to negative, which indicates that there is unobservable heterogeneity and a dynamic related to past performance; our results indicate that controlling for more lags of Tobin's Q leads to a non-linear relationship. However, both models of the dynamic GMM—with one lag and two lags—have a very weak coefficient which may indicate a non-existent relationship.

Similar to ROA, the results based on the dynamic GMM suggest that family or individual ownership (FAMOWN) has a highly significant negative effect on Tobin's Q with a very weak coefficient related to Tobin's Q. However, the static OLS was found to be insignificant; controlling for endogeneity and solving the problem of unobservable heterogeneity led to finding high significance with a negative sign on Tobin's Q. This finding indicates poor legal investor protection in some developing countries, which corresponds to the findings of Omran et al. (2008), who also found that family or individual ownership has a negative and significant impact on firm performance. This result indicates that family ownership interest appears to expropriate minority shareholders, which means that the family looks after its own interests to such an extent that residual profits available for minority shareholders are limited (La Porta et al., 1999; Shyu, 2011).

Similar to ROA, the dynamic GMM found a positive and highly significant relationship between government ownership (GOVOWN) and Tobin's Q. The results reveal that government ownership has a highly positive significant effect on Tobin's Q, even when controlling for past performance. This finding is along the same line as those of Sun et al. (2002) and Omran et al. (2008), who examined government ownership and firm performance and found a positive relationship between the two. In addition, the Saudi government supports and funds the Saudi stock market to get better performance by owning a substantial portion of the listed companies and giving some of the listed companies debt with less interest to enhance infrastructure. This argument explains the strong positive relationship between firm performance and government ownership. In addition, a board member who acts as a representative of any government agencies that own some shares in the company has the incentive and power to monitor and control management, and also plays a significant role in corporate governance (Xu and Wang, 1999).

In contrast to the ROA, the dynamic GMM found the coefficient on the foreign ownership (FOROWN) to be statistically positively significant for Tobin's Q when controlling for endogeneity and controlling for one lag, but found a very weak coefficient that explained the relationship between foreign ownership and Tobin's Q. However, with two lags, the current study found no relationship between foreign ownership and Tobin's Q. In emerging markets such as Saudi Arabia, listed companies need additional assistance from foreign investors to reach enhanced future firm value. This finding is in line with the results of Dimelis and Louri (2002), Bai et al. (2004), Douma et al. (2006) and Sulong and Nor (2010). Tobin's Q indicates that expected higher foreign ownership gives the company advanced technology, experience and enhanced firm value in the future (Dimelis and Louri, 2002). The impact of foreign ownership on Tobin's Q is positive because foreign investors provide good resources and capabilities that lead to increased future growth opportunities (Douma et al., 2006).

The result of the financial firms ownership (FINOWN) is positively significantly related with to Tobin's Q. This result is inconsistent with static OLS. The intuition behind the dramatic static flip (from insignificant to significant) on the coefficient on the financial firms ownership is an interesting one and illustrates the bias that may arise from ignoring both unobservable heterogeneity and the dynamic relationship between financial firms ownership and past firm performance. Ang et al. (2000) highlighted that banks and financial institutions have skills and knowledge which lead to good monitoring. Our result is consistent with Prowse (1992), Nickell et al. (1997) and Lehmann and Weigand (2000).

In contrast to ROA, the dynamic GMM found the non-financial firms ownership (NFINOWN) highly significant with a positive effect on Tobin's Q. This finding is supported by Morck et al. (2000), who found a positive relationship between Tobin's Q and non-financial ownership. Moreover, large shareholders such as corporations can reap large benefits for themselves and other shareholders by becoming informed and possibly by influencing corporate outcomes because they hold a block of voting right power (Zeckhauser and Pound, 1990).

With respect to the control variables—firm size (FSIZE) and industry types (IND) —this study found, after controlling for endogeneity with the dynamic GMM, a negative and significant relationship between firm size and Tobin's Q. This result is supported by Andres and Vallelado (2008), who found a negative relationship between firm size and Tobin's Q under the GMM technique. Similar to ROA, the industry types were found to be negative, except the investments industry, which was found to be positively related to Tobin's Q.

Table 7-9 GMM Results

Ind. Var.	**Dep. Var – ROA**		**Dep. Var Tobin's Q**	
	1	2	1	2
Constant	-11.862 ***	-21.713 ***	6.519 ***	3.944 ***
L1	0.139 ***	0.32 ***	-0.0719 ***	0.297 ***
L2		0.146 ***		0.13 ***
BSIZE	0.386 ***	0.312 ***	0.006	-0.005
NEXE	-0.243 ***	-0.111 *	0.007	0.01 ***
FBM	1.039 ***	1.066 ***	-0.017	-0.058 ***
BCOM	2.738 ***	3.458 ***	-0.09 ***	-0.157 ***
MANOWN	0.235 ***	0.245 ***	0.002 ***	-0.003 **
FAMOWN	-0.260 ***	-0.236 ***	-0.004 ***	-0.003 ***
GOVOWN	0.084 ***	0.011 *	0.031 ***	0.013 ***
FOROWN	-0.4 ***	-0.397 ***	0.008 ***	0
FINOWN	-0.203 **	-0.177 **	0.067 ***	0.05 ***
NFINOWN	-0.151 ***	-0.159 ***	0.018 ***	0.01 ***
RFBM	-0.613	-1.777 **	-0.33 ***	-0.134 ***
IND1	-6.111 ***	-3.119 ***	-1.485 ***	-0.759 ***
IND2	-0.864	2.011	-0.122	-0.035
IND3	-10.178 ***	-3.135 ***	-0.921 ***	-0.672 ***
IND4	3.321 ***	2.680 **	0.225 **	0.364 ***
FSIZE	1.247 ***	1.529 ***	-0.356 ***	-0.199 ***

Years 3	-1.86 ***		0.196 ***	-0.042 ***
Years 4	-1.396 ***	1.504 ***	0.203 ***	
Years 5	-2.054 ***	0.676 ***	0.404 ***	0.22 ***

7.10 SUMMARY

This study examined the relationship between corporate governance mechanisms and firm performance using three types of regression techniques: OLS, 2SLS, and GMM. This study used two variables to measure firm performance, ROA and Tobin's Q, and used various corporate governance mechanisms as independent variables.

The first regression model is ordinary least square (OLS) and, given the problem of multicollinearity, OLS regression offers three potential solutions: do nothing with multicollinearity, drop managerial ownership and, in the last regression, drop family or individual ownership. All of these regressions will be applied after winsorising. Ultimately, all three models produced similar results. Based on the ROA, most corporate governance variables have a significant relationship with ROA, except for, non-executive board members, board sub-committees, and financial firms ownership.

All board structure variables were insignificant with respect to Tobin's Q, as there may not be much variation in the board structure variables in Saudi Arabia, with little variation in board size, non-executive members, family board members, royal family board members, and board committees. Such an explanation, however, is less convincing given that this lack of variation in the board structure variables would also lead to insignificant results with regard to ROA. For more explanation, Tobin's Q is forward-looking and is based on investors' expectations. It is quite consistent for investors to believe that board structure does not matter for future performance, perhaps because investors think that the size of the board of directors is not an important aspect of corporate decision making governance, such as board size which concern on quality not quantity, while in practice it does make a different to performance. The actual effect on performance would show up in ROA, but the investors' belief that board structure is irrelevant would lead to no statistical significance in Tobin's Q. On the other hand, the OLS found a significant relationship with just three types of ownership structure, namely, government ownership, foreign ownership, and non-financial firms ownership.

The second regression is 2SLS and, along with the OLS results, most variables similarly affected firm performance, albeit to different extents and levels of significance. The 2SLS found a negative effect of non-executive member on the ROA, while the OLS found no significant relationship between them. Based on Tobin's Q, there is no longer significance with board of directors structure variables, except for the presence of royal family board members, which was found to be significantly and highly positively related to Tobin's Q.

For the third regression, this study applied GMM to examine potential endogeneity problems, detect unobserved heterogeneity, and examine the dynamic relationship between corporate governance mechanisms and past performance. This study applied the dynamic GMM with both one lag and two lags. All the corporate governance variables were found to be significant, and the dynamic GMM detected some of the unobserved heterogeneity and potential endogeneity. The intuition behind the dramatic sign or statically flip on the coefficients of several corporate governance variables is the bias that might arise from ignoring both unobservable heterogeneity and the dynamic relationship between corporate governance variables and past firm performance. For example, board sub-committees, non-executive members, and financial firms ownership are highly significant after detecting unobserved heterogeneity and controlling for endogeneity.

Chapter nine will present the general discussion and conclusions of all three regression models. It will also provide a comparison of the models, while linking the results of the two methodological approaches used in this study, both quantitative and qualitative. Next chapter will present the analysis of the semi-structured interviews in detail.

8 INTERVIEW RESULTS AND DISCUSSION

8.1 INTRODUCTION

This chapter analyses the results of semi-structured interviews conducted with 17 participants representing different stakeholders (see Table 8.1). Each participant has specific views about corporate governance in Saudi Arabia. The main objective of this chapter is to explore in more detail the corporate governance mechanisms in Saudi Arabia, focusing on the relationship between corporate governance mechanisms and firm performance. Interviews were conducted in Arabic and lasted between 45 and 70 minutes. Some participants agreed to have their interviews recorded, while others only agreed to note taking.

Of the 17 participants, there were two non-executives with broad experience in Saudi joint-stock companies, three shareholders with a 5% or higher stake in joint-stock companies, two board secretaries responsible for preparing board-meeting agendas, one Capital Market Authority (CMA) regulator, one government representative from the board of directors of joint-stock companies, and two auditors. In addition, semi-structured were interviews conducted with two academics that have research interests in corporate governance and the Saudi capital market. Furthermore, there were two interviews conducted with CEOs who have Masters Degrees, and two with chairmen. One of the chairmen has more than eight years' experience as a chairman in joint companies listed on the Saudi stock market, and the other comes from background in accounting and auditing, holds a PhD degree, and has worked as an external auditor for many years. Thus, all respondents were qualified, knowledgeable experts with experience in corporate governance and the Saudi capital market.

The interview questions cover three main areas. The first area examines the understanding of corporate governance concepts among different stakeholders in Saudi Arabia, focusing on the definition and importance of corporate governance in the Saudi stock market. The second area deals with evaluating, developing, and improving current corporate governance regulations, and discussing difficulties companies listed in the capital market have with corporate governance practices. The third area focuses on examining the relationship between corporate governance mechanisms (boards of directors and ownership structures) and firm performance.

Table 8-1 Respondents' Profiles

NO	Position	Code	Sector
1	Shareholder	SH1	Petrochemical Industries and Real Estate Development
2	Shareholder	SH2	Cement , Petrochemical Industries and Retail
3	Shareholder	SH3	Multi-Investment, Cement, Building and Construction, Agricultural and Food
4	Chief- Executive Officer	CEO1	Building and Construction
5	Chief- Executive Officer	CEO2	Industrial Investment
6	Chairman	CH1	Petrochemical Industries
7	Chairman	CH2	Hotel and Tourism
8	Regulator	R1	Capital Market Authority
9	Academic	AC1	King Faisal University
10	Academic	AC2	King Faisal University
11	Board Secretary	SEC1	Petrochemical Industries
12	Board Secretary	SEC2	Building and Construction
13	Auditor	AU1	Saudi Accounting
14	Auditor	AU2	Saudi Accounting
15	Government Representative member	GOV1	Public Pension Agency
16	Non-executive	NEXE1	Multi-Investment, Hotel and Tourism and Petrochemical Industries
17	Non-executive	NEXE2	Building and Construction, Banking and Insurance Industries and Energy and Utilities

8.2 THE UNDERSTANDING OF CORPORATE GOVERNANCE CONCEPTS IN THE SAUDI ARABIAN ENVIRONMENT

In order to examine the understanding of corporate governance concepts among different stakeholders in Saudi Arabia, this section focused on the definition of corporate governance. Also, this section discussed the important of corporate governance.

8.2.1 DEFINITION OF CORPORATE GOVERNANCE

Most interviewees stated that corporate governance is a system governing how the company is managed and controlled via the board of directors in order to adhere to investors' interests. However, the definition of corporate governance differed depending on which stakeholder group the interviewee was a member and therefore their interests.

One of the more experienced investors in the Saudi Capital Market, who owned more than 5% of a joint stock company, said (SH1):

> *In 2005, the investors did not care about the corporate governance concepts, and did not ask for any information about the structure of the board of directors. ... The main thing the investors are looking for is high profit .... After the big crash in 2006 the Capital Market Authority issued the codes of corporate governance to protect investors. When the regulators issued these codes, most of the investors did not have a lot of knowledge about corporate governance and what its main function is. Now, I feel more comfortable with implementing the corporate governance codes to save my investments.*

Furthermore, another shareholder in a joint stock company stated (SH2):

> *Most shareholders lack knowledge of the concepts and definition of corporate governance. ... We need some training courses and lectures from the Capital Market Authority to explain the concepts and the main functions of corporate governance, as well as to explain the theories related to corporate governance such as agency theory.*

A further shareholder agreed with SH2's view; this person, SH3, argued:

> *The concept of corporate governance in Saudi Arabia is still new, and the Capital Market Authority in Saudi Arabia just provides us with guidelines without any details. ... Actually, we need more and more background information, as well as explanations of these current codes in more detail and in easily understood language.*

A non-executive director who is a new member of the board of directors of a joint stock company in Saudi Arabia stated (NEXE1):

To my knowledge, the new corporate governance regulations in Saudi Arabia are impossible to apply because of the lack of details. ... The Capital Market Authority gave the listed companies in the market three years to prepare their companies to implement these regulations, and is going step by step to achieve the best practices.

The chief executive officer of one of the manufacturing joint stock companies defined corporate governance as (CEO1):

A system and rules that control the work of the company. This system ensures the interests of shareholders, board of directors, and other stakeholders such as employees. ... I see the corporate governance system as a manual to guide the board of directors in how to manage the company in the right way.

The chairman of the one of the petrochemical companies (who comes from a background in accounting and auditing, and who is also a non-executive director of two other Saudi companies) defined 'corporate governance' using a comprehensive definition that included all stakeholders related to the company. He said (CH1):

The group of rules, regulations, policies, and principles of managing companies using the best practices ensures the protection of all stakeholders that have interests in the company. In addition, these best practices control the relationship between shareholders and the board of directors, as well as between the board of directors and the executive department of the company, to achieve accountability and responsibility.

A regulator who is responsible for regulating and supervising corporate governance in Saudi Arabia defined corporate governance from a wide stakeholders' perspective. He stated (R1):

Corporate governance is a group of procedures, policies, and regulations that concern the relationship between shareholders and the board of directors, as well as between the board of directors and executive management and other stakeholders such as banks, employees, clients, and suppliers. I mean, here the board of directors reflects the interests of shareholders and also other stakeholders. We have three dimensions (shareholders, boards of directors, and other stakeholders); the main responsibility of the board of directors is to ensure the protection of all

> *stakeholders—not just shareholders or minority shareholders—and also to ensure that there is no conflict between these three dimensions.*

One of the academic members of Saudi University who has some interest in the corporate governance environment in Saudi Arabia has a specific view of corporate governance (AC1):

> *In my opinion, corporate governance in Arabic is* aledarh alrasheedah, *which means a comprehensive system that has many aspects to achieve; this comprehensive system guides us on how to manage, control, and direct the company in the best practices to protect stakeholders' rights, achieve accountability and fairness, and promote disclosure and transparency in the board of directors' reports, thereby reducing the risk of corruption and protecting the firm from conflicts of interests.*

In summary, the definition of corporate governance reflects various views that depend on the position of the participants. Some of the participants look at corporate governance as a narrow path. This narrow view is consistent with Sir Adrian Cadbury (1992, p. 7), who defined corporate governance as "the system by which companies are directed and controlled," which means this group of participants focused on the internal process of corporate governance and were concerned about the responsibilities of the board of directors to manage the company using the best practices to protect the shareholders' interests. Other participants have broader views of the definition of corporate governance. This view is consistent with Solomon (2010, p.6), who defined the corporate governance as "the system of checks and balances, both internal and external to companies, which ensure that companies discharge their accountability to all their stakeholders and act in a socially responsible way in all area of their business activity."

8.2.2 THE IMPORTANCE OF CORPORATE GOVERNANCE REGULATIONS

All participants in the interviews agreed that corporate governance has a positive impact in terms of organizing the work of the companies. In addition, almost all of the participants stated that the corporate governance system is essential to providing more comfort for all stakeholders. This section discusses the importance of these codes in one of the largest stock markets among developing countries.

A non-executive member of a board of directors stated (NEXE2):

> *I do agree that the corporate governance system is comprised of very important rules to establish the joint stock company. Moreover, it helps to achieve fairness between stakeholders to get the information that they need to make the investments decision.*

Another academic researcher on corporate governance in Saudi Arabia mentioned (AC2):

> *I feel that the corporate governance is very important factor to increase and get best performance and also, to improve the company to have high level in the capital market with good internal control.*

In addition, some participants agreed with La Porta et al. (1997,1998, 1999 and 2000), who indicated that the separation of management from ownership is one of the biggest advantages of corporate governance. A board secretary in a joint stock company in Saudi Arabia stated (SEC1):

> *I think that the separation of ownership and control is one of the most important aspects of corporate governance; it will lead to many advantages for all stakeholders. Such an increase in a firm's valuation in the capital market will invite qualified non-executive members who have more experience in specialties the company need, as well as, in the present, corporate governance—or let me say good corporate governance practices—can increase the investments in the company by attracting foreign investors and enhancing equitability treatment for all stakeholders.*

One of the chairmen stated (CH2):

> *Before 2006, there was no requirement for disclosure and transparency of the information related to non-financial (operating), which helps in making good investment decisions, but now, with the implementation of corporate governance, we can get a full picture of the company that gives the shareholders more confidence in their investments and obtaining fairness for all parties.*

Furthermore, the corporate governance system has a vital role in enhancing the macroeconomics of the country and building a sound picture of a trustworthy capital market. Also, good corporate governance leads to a deceased investment risk and lower levels of company corruption. The regulator stated (R1):

> *There is no doubt … that corporate governance decreased the severity of the crash of the capital market and reduced the capital market crisis. Implementing the regulations of corporate governance makes our capital market more trustworthy, and the existence of corporate governance enhances economic improvement; in contrast, weak corporate governance leads to cheating, corruption, and fraud.*

There is a number of participants suggested that the existence of good regulations of corporate governance have a vital role to attract both of foreign and local investors to invest in the Saudi capital market. A chairman (CH1) of one of the joint stock company stated that:

> *Absolutely, it is true, good practices of corporate governance lead to many important advantages, one of these advantages is attracting investments for both local and foreign investors. To be honest with you, there is a number of Saudi investors invested their money in the developed country especially before 2006, and after the corporate governance existence in the Saudi listed companies, most of the local investors returned to the Saudi capital market. In addition, nowadays, some of the foreign investors invest some of their money in the Saudi capital market as one of the largest capital market in the MENA.*

Another interviewee (CEO 1) mentioned that:

> *Because of globalization and privatization, this leading to pay attention to attract foreign investors to invest in the Saudi Arabia which lead to have a good access of capital and funds to the listed companies.... honestly, the attracting of the foreign investors are very important not just for the listed companies but also, for the enhance the economic growth and good for infrastructure.*

Overall, the participants agreed that corporate governance regulations are essential, both for companies themselves and to build a good reputation for the Saudi capital market. Corporate governance is important for all stakeholders. Some participants took an agency perspective regarding shareholder protection; others, seeing corporate governance as a stakeholder perspective, noted the need to protect interests of the stakeholders and establish fair and equitable relationships among shareholders, boards of directors, and executive managers.

8.3 THE EVALUATION OF CURRENT CORPORATE GOVERNANCE REGULATIONS

This section focuses on the interviewees' opinion of current corporate-governance regulations in Saudi Arabia. The interviewees were asked to evaluate the current codes, focusing on whether or not the codes need to evolve. Also, this section discusses regulation issues that interfere with corporate-governance practices for companies listed in the capital market.

Most participants mentioned that the current corporate governance regulations give the listed companies guidelines without providing in-depth details. They suggested that to apply and implement the corporate governance regulations the companies need more information. They also mentioned that explaining the codes in easy-to-understand language would help the companies implement them correctly and achieve corporate governance goals. Thus, on the subject on the need to keep the regulations up-to-date one chairman stated:

A chairman stated that (CH1):

> *The current regulations of the corporate governance are in a manual that should be used by the company to manage the firm in the best practices. In my opinion these regulations are, in general, good as a first draft of the corporate governance codes in the Kingdom. But, these regulations are still new, as well as the economy in Saudi Arabia is growing rapidly, which mean these regulations need to be updated.*

A shareholder said (SH3):

> *I own a number of shares in a number of listed companies. I think the existence of the corporate governance is very important in our economy, but I demand the Capital Market Authority issues the manual for more details and explain to the investors … in easy language for us ... I mean by [us], the investors like me who are old [LAUGH] and don't have any qualification in any area in businesses.*

A number of participants agreed that some of the listed companies have not complied with corporate-governance regulations in the past. However, all companies listed in the capital market now meet the mandatory codes and apply the principle of 'comply or explain' in their reporting.

An auditor (AU1) stated:

I would like to indicate to something. From 2007 until 2009, there was a lack of compliance, and the annual reports were also lacking disclosure about the information related to the board of directors. The board of directors just mentioned the financial statements and external audit reports. However, in the present, all companies listed in the capital market implement the regulations and apply the concept of "comply or explain." Now, the annual reports issued by the company disclose the information about the board of directors such as the names of the board members, the classification of the board members, the shares owned by the board members, the large of the ownership who owned 5% and more of the company shares, operation process and products, and also, the financial statements. This is information that is really what the investors need to make decisions.

Another external auditor for joint-stock companies in Saudi Arabia approved of the idea that petrochemical companies listed in the capital market should have higher levels of compliance with all corporate governance regulations, not just the mandatory codes. An external auditor stated (AU2):

I would like to point out something. The compliance of the corporate governance among the joint-stock companies differs from one company to another, and most of the petrochemical ... companies have strong compliance with all corporate-governance regulations. To be honest with you, the compliance of the corporate governance regulations, you find in the companies have a strong board of directors members, also, in the other sectors, not just with petrochemical companies..... But I said that because I had more experience with the petrochemical companies.

Surprisingly, some companies listed in the capital market set up their own corporate-governance regulations derived from the OECD principles of the corporate governance. These companies applied the principles of corporate governance unofficially before the Capital Market Authority issued its codes in the end of the 2006, which give them more ability to apply the regulations. A regulator (R1) noted that:

When we issued the regulations of corporate governance, we found some companies applied their own codes ... derived from the OECD. These companies applied these codes unofficially to build a good reputation in the capital market. Also, when the Capital Market Authority issued these regulations, these types of companies had a *good ability to apply all codes before become mandatory by the Capital Market Authority.*

Most participants considered disclosure, transparency, and an active board of directors to be elements that require to be developed in the Saudi stock market. According to Al-harkan (2005), the Ministry of the Commerce and Industry (MOCI) in Saudi Arabia approves the sufficiency of all information and data related to financial statements and operations in order to help shareholders assess firms' performance and make good investment decisions. Thus one shareholder stated:

A shareholder stated (SH2):

Disclosure is one of the very important elements of the regulations of corporate governance. As you know, disclosure is a demanded element from the Ministry of the Commerce and Industry before the Capital Market Authority. That gives this element a very important and vital role in making decisions. Now, the current regulations of corporate governance focus on disclosure and transparency related to all information that they think and expect to lead to the right decisions …. But, unfortunately, some companies hide some important information, which leads to a deficient disclosure system leading to wrong investment decisions. Therefore, I agree that an improved disclosure and transparency system can be achieved by the corporate governance system.

A number of participants suggested that the CMA needs to improve the corporate governance regulations by inviting foreign members from international bodies, such as the OECD, to develop the current regulations. The expertise of foreign members would provide the CMA with the knowledge and experience necessary to improve regulations in relation to appointing non-executive members, setting the functions and establishing the membership of sub-committees, and setting salaries and bonus levels for executives, particularly those in family businesses. Thus, one CEO stated (CEO1):

There is no doubt the current regulations of corporate governance need to improve to get more best practices. Unfortunately, the current regulations lack regulations related to the nonexecutive members and how they are appointed. Also, the current regulations concerning the audit sub-committees don't mention the remuneration and nomination of sub-committees. We suggest the Capital Market Authority give the *remuneration and nomination sub-committees a more vital role to bring good members to the board of directors, and also to set the rules and standards for salaries and bonuses of the executive members.*

Furthermore, some interviewees considered the need to improve internal control systems in companies.

As one board secretary mentioned (SEC2):

OK, corporate governance regulations are important and helpful for increasing the investment opportunities in the firms and making the investors more comfortable for their shares in … companies that have a good corporate governance system. But, to be honest with you, the corporate governance I think doesn't [do] enough. The company needs clear internal-control system regulations issued by the Capital Market Authority to complete the work of corporate governance. I suggest the Capital Market Authority establish a specific chapter in the corporate-governance regulations that deals with the internal-control systems.

Other participants highlighted difficulties that can interfere with corporate governance practices in the companies. One of these difficulties is the lack of awareness by stakeholders. This obstacle arises from the misunderstanding of the objectives of the corporate governance regulations. One non-executive member stated:

A nonexecutive member (NEXE1) stated:

In my opinion, the society [stakeholders] must ask the Capital Market Authority to hold seminars to introduce the benefits of corporate governance. Actually, there is a lack of awareness about the definitions and importance of corporate governance for all stakeholders, not just for investment decisions, but also for raising the level of awareness and increasing the education of the stakeholders.

Another participant stated (AC1):

It is very important to discuss and explain the important of corporate governance regulations for raising the awareness of all stakeholders that have interests in the company. For example, the stakeholders need to know what exactly happens to some

> *companies that abandon ... corporate governance, such as Enron and WorldCom, and [the results of doing so]! I think when the stakeholders listen carefully to some stories about fraud, corruption, and scandals, that will enhance their awareness ....*

Another difficulty arises from the corporate-governance regulations being costly and lengthy to implement. One participant stated (CH2):

> *When I became the chairman of this company, the main goal that I wanted to achieve was building a good corporate governance system. It took me and my team meeting many times to establish the requirement of the corporate-governance regulations .... Actually, this problem, to be honest with you, arises from us because we don't have more experience and knowledge regarding corporate governance functions! Furthermore, I think in my view the corporate governance is a costly system, because it needs to obtain some advice from specialists and ... sometimes we invite foreign members who have experience to help us to build a good corporate governance system.*

In summary, most participants suggested that the current corporate governance regulations were in reality a first draft. They also agreed that stakeholders need more detail in order to implement the current codes correctly. The most important idea is to develop disclosure and transparency, particularly in reports by boards of directors. A lack of information and the cost of the implementing corporate governance systems are the issues most directly related to successfully applying a corporate governance system in the Saudi Arabian business environment.

8.4 CORPORATE GOVERNANCE AND FIRM PERFORMANCE

This section contains two dimensions—board of directors and ownership structure—that are consistent with the main objective of this study. The researcher asked several questions about the mechanisms of the board of directors and ownership structure in the Saudi listed companies, and how these mechanisms affect firm performance. The researcher used this qualitative approach to support the main results of the quantitative approach (the results from the regression analysis). Chapter Nine links the results of these two methods with the main findings and conclusions.

The majority of interviewees indicated that best practises of corporate governance lead to good firm performance and a good valuation of the Saudi capital market. A CEO argued that (CEO1)

> *The good mechanisms of internal corporate governance codes would be lead to improved firm performance... Actually, this is a positive relationship between good corporate governance and firm performance. A good corporate governance system improves the internal control system and enhances disclosure and transparency*

Another interviewee agreed but stressed that it must be best practice:

> *Of course good corporate governance mechanisms positively affect firm performance. Let me say something, not all corporate governance assures good performance, sometimes there is weak corporate governance mechanisms and they maybe do not have any effect on firm performance. I mean here, corporate governance should contains a good practises to enhance firm performance with for example concern on mechanisms of board of directors structures and comply with these good practises to ensure best performance.*

8.4.1 BOARD OF DIRECTOR STRUCTURE

8.4.1.1 BOARD SIZE

Some participants agreed that board size does not matter in determining firm performance. Furthermore, several participants stated that the quality of the board members is more important than the size of the board. Thus one chairman of a joint-stock company in Saudi Arabia stated: (CH1)

> *Let me honest with you: there is no clear relationship between board size and firm performance. In my opinion, it depends on the quality of the board's members, such as experience of the members..., when we look at the listed companies in the capital market, we see that some companies have small board size and have achieved high performance, and also, we can see large board size with high performance ... I would like to focus on the quality more than quantity.*

Moreover, one of the non-executive members suggested: (NEXE2)

> *I think the size of the board of directors does not have any effect on firm performance. The main issue of the board relates to the requirement of appointing the board members ... I am a non-executive member on two boards, and we have tried to invite persons who have a qualification or expertise in a specific field that the company needed.*

However, one academic member with a research interest in corporate governance and capital markets in Saudi Arabia argued that the relationship between board size and firm performance in the Saudi listed companies is unknown. He stated (AC2)

> *I have some interest in research on the dynamic of the corporate governance mechanisms in the developing countries in general with a greater focus on Saudi Arabia; in my observations of the some joint stock companies in Saudi Arabia, the curve that describes the relationship of the board size and firm performance doesn't reflect a clear relationship; sometimes it seems to be negative and sometimes positive.*

In contrast, a number of participants stated that board size was positively related to firm performance and also suggested that the size depends on several factors such as capital structure and firm size. These participants take the view that more board members, which entails more experience and qualifications, lead to better performance. Thus, one non-executive member said (NEXE1)

> *I strongly agree that the board of directors is a very important element in determining firm performance, and the board of director size depends on many factors such as the capital structure, total assets and don't forget the industry type. Based on my experience with 10 years acting as a board member with various industries, large board size with diverse qualifications leads to more knowledge and develops the firm performance in the future.*

The CEO of another company suggested one advantage of a large board is that it increases the number of cross-linked members who are on other boards and assists them in sharing experiences and solving problems encountered in other companies. He stated (CEO2)

> *Let me say something about the board size. I attended a conference about the mechanisms of corporate governance, and saw some seminars about the board of directors structure. Most of these seminars concluded that the relationship between board size and firm performance is negative, especially in the developed economies. But, I think in the case of Saudi Arabia, we need large boards in the first stage to improve the board quality with sharing experiences between firms among interlocking members, which leads to getting more skills and different opinions. For, example, the board of directors of our company has ten members with various backgrounds; we have an accountant, banker, marketing researcher, lawyer, and petrochemical engineer. This team works together to build a good plan and enhance the firm value in the capital market.*

However, the majority of the participants suggested that the ideal board size is eight to ten members with various backgrounds. One CEO of a joint-stock company stated (CEO1)

> *The average size of the board of directors that is suitable with the Saudi Arabian listed companies is between eight and ten; also, I have no doubt that a small board is more active and easy to monitor; add to that, the small board given to me as a CEO has more ability to discuss and listen carefully to other members, which leads to quick decisions. But my view is the size of the board of directors is about eight or nine with various backgrounds and knowledge. I mean here, I support the large board with some cases when the company needs more experience and particular fields and qualifications, and, the large board can easily establish the environmental linkage and collect more resources, which leads to high performance.*

In conclusion, this study has two important views about board size. The first view is that board size does not matter in the case of Saudi Arabia at the present time, but the concern should be about the quality of the board members rather than quantity. A contrasting view is that a large board is more suitable for the Saudi listed companies but should not consist of more than ten members all of whom should diverse backgrounds in order to establish a good quality board of directors and increase and enhance firm performance. Most of those who support the second view agreed that it might be advisable to establish a large board in the first stage to develop the company, and later, when the company is more mature, the number of members can be reduced to a size that is more suitable to the firm size while maintaining the quality of the board members.

8.4.1.2 NON-EXECUTIVE MEMBERS

The second variable in the structure of boards of directors is the number of the non-executive members. The researcher asked four main questions related to the non-executive members. All participants agreed that the board of directors has four main officers, including the CEO, who should be an executive member, non-executive members, a chairman, and other executive members. The majority of the board of directors are non-executive with the exception of the CEO and perhaps one or two more executives. However, there are a number of companies that have a lower percentage of non-executive than executive members. Most participants stated that the non-executive directors must have good experience, good qualifications, and a good external relationship with the environment and society. In addition, some companies appoint non-executive members because of their wealth or their holding of investments in the company. According to Al-harkan (2005), Saudi listed companies appoint non-executive members to provide check and balance mechanisms and to control management performance. One of the requirements for appointing non-executive members in Saudi listed companies is that they own at least 1,000 shares of the company stock.

Thus most participants highlighted that the non-executive members have an important and vital role on the board especially when they are carefully selected. They argued that the most important role of the non-executive members is assisting in making crucial decisions. In addition, they should reflect the opinions of the shareholders. Therefore, one CEO stated (CEO2):

> *Successful boards of directors should have a mix of expertise in non-executive members with different backgrounds and qualifications to reach good decisions and approve good plans and strategies for the company. Also, they have to work with the CEO to manage and control the company with best practices.*

However, one of the chairmen was critical (CH1)

> *.... honestly, the non-executive members do not necessarily have the qualifications to become board members... they may just have wealth and power that the company needed; however, the CEO of the company seeks to invite*

some of the non-executive members that the company actually needs to fill the gap and improve the performance of the firm.

In addition, one shareholders had a bad experience with non-executive members. The company had appointed a non-executive who was a wealthy person who had a good relationship with large shareholders but who had little if any experience or knowledge. The shareholder claimed (SH3)

I owned shares in various companies with different industry types... the petrochemical companies select the non-executive members very carefully and select members who have knowledge and experience in the petrochemical operation. In contrast, a number of companies appoint non-executives because they have relative relationships with the large shareholders or may be friends with them.

Another shareholder concurred (SH2)

I would like to say something that I think is very important when the company appoints non-executive members, which is the culture of social life. The Saudi environment cares about social relationships between the CEO and non-executive members ... some of the CEOs invite their friends or relatives to become a non-executive; to be honest with you, some companies use this criteria but the majority of the listed companies are looking for the experience and qualifications to enhance firm performance.

When asked about the requirements for appointing non-executive members the majority of participants stated that there are no clear requirements. They demanded that the Saudi CMA set requirements as a guideline to appointing non-executive members so as to make shareholders more comfortable, safeguard their investments, and attract additional local and foreign investment. Thus, one CEO stated (CEO1)

There is no clear requirement for appointing non-executive members, but let me tell you something important: at present, most of the listed companies seek to increase efficiency, productivity and attract foreign investment to build an international brand name in the world; all of these objectives will not come true *without inviting expertise and foreign non-executive members who have loyalty and responsibility to increase the firm value to become one of the leading companies in the market.*

Furthermore, the absence of the power, experience, skills, and qualifications of non-executive members may give the executive members the power to use their responsibilities irresponsibly to achieve personal interests that may conflict with shareholders' interests. This conflict may destroy the value of the company. As one chairman asserted (CH2)

I strongly agree, the absence of skills, knowledge and experience in the non-executive members may be lead to weakness in the company and also give the executive members on the board more chance and possibility to achieve their interests and personal ambitions. Also, the absence of the power of non-executive members gives the executives freedom to withdraw loans from the company account without any limit or terms. These bad practices lead to a weakness in the firm's value in the capital market and the investors withdraw their investment and money from this company. This case occurred exactly in two or three listed companies. Because of that, the company must choose their non-executive members very carefully, and choose the members who reflect the desire of the shareholders and also minority shareholders.

An auditor agreed (AU1)

It is an easy mathematical equation: when the company appoints non-executive members who have poor experience and knowledge this will lead for sure to bad performance and decreases the foreign investment, and in the contrast, the existence of the non-executive members with high qualifications and more experience leads to developing and improving the national growth with the firm value and makes the Saudi capital market one of the leading markets in the emerging economies.

Another auditor also supported the argument (AU2)

I think the non-executive members in one company that I audited have a negative impact on firm performance. I tell you that because the procedure of

> *the membership in this company is very poor. Ok, I will be become more honest with you, a number of the non-executive members appointed on the board depend on favouritism and they don't have any experience or knowledge. Also, let us draw a clear picture, we have large shareholders who own 10% or more of the company shares, and these large shareholders and founders of the company are controlling the company and appoint the non-executives... maybe they bring members with specialties in a specific field whom they need. But keep in your mind, I think they bring the member that is comfortable to work with.*

In sum, the majority of participants stated that non-executive members should have knowledge and experience that helps to improve firm performance. The participants mentioned that there are no requirements for appointing non-executive board members. In addition, the participants considered that non-executive members play a very vital and important role if they are selected carefully.

8.4.1.3 FAMILY BOARD MEMBERS

In this section, the researcher asked questions about the role of family board members and whether or not there is any relationship between the presence of family board members and a firm's performance. Most participants claimed that family board members have a vital role in the board of directors, especially in a family business, as well as in companies where the family owns a large stake in the shares. Thus, one chairman of a joint-stock company stated (CH1)

> *I strongly agree that the presence of the family member on the board of directors has a significant vital role in monitoring and managing the company to the best practices and also to make good decisions that serve the company and investors. ... This member represents the large family investment in that company; add to this point, the family member cares about the family's reputation, which gives the family board member more responsibility.*

In addition, a number of interviewees mentioned that the name of the family makes investors and shareholders more comfortable. Furthermore, a family's reputation attracts more investors, which encourages the CEO to maintain his family's reputation and play a significant role on the board. In this context, one shareholder who own shares in one of the biggest family companies in the stock market explained (SH1):

> *For most of the family businesses listed in the capital market, the CEO is from the same family, and I think that is good, because this give the CEO more responsibility about the family investment and concern about building a company brand globally to attract foreign investment. Add to that, the CEO from the same family seeks to protect the family reputation.*

A further benefit of family board members according to the respondents is that monitoring and managing a company through the family member is not only advantageous for the family business but also for all companies in which the family owns shares and are nominated as board members. This advantage is derived from the ownership of the large number of shares in the company, giving the family board members more ability to monitor the company and remove the CEO if he is unable to manage the company. One chairman of one of the joint-stock companies argued (CH2)

> *The family board members have a very important role not [only] in the family business but in all companies [in which] the family own shares. Because the family board members have a view seeking to save and care [for] their investment and money in the company … and they have a positive impact on the company work by removing a bad CEO who has no power or ability to manage the company. Also, they may have a negative [impact] by control [of] the company and destruction of minority interests. … They may remove a good CEO because he is not from the same family or a relative.*

However, some shareholders are aware of the lack of qualifications and experience of a family member and, therefore, consider that the family member does not have ability to manage a company. In addition, the other shareholders do not trust the board of directors' decisions. As one shareholder declared (SH1)

> *There is one point in my mind: What happens when family board members don't have any skills or experience? … I think he will make wrong or random decisions; these decisions will be a detriment to the company in the long term. Also, in my opinion, he may be the third generation of the family who does not*

> *feel any responsibilities toward the company. ... In the family business, the family board members take large salaries and big bonuses because they hold the same name as the company (SH1).*

Arguing against this, one government representative, who is also on a board of directors, argued (GOV1)

> *I have good news. I am a board member of one of the family businesses. The majority of the second and third generations were educated in the UK and the US to prepare themselves to manage their business in the future.*

Most participants perceived there to be a positive relationship between a family board member and the firm's performance. This positive relationship occurs when the family board member cares about the family's investment and reputation. This loyalty enhances and increases the firm's performance. This one regulator of the Saudi capital market stated (R1)

> *I think the relationship between a family board member and firm performance is positively related. My view is supported by the family member caring about the family business reputation in the market. ... This gives the family board member more energy and power to attract local and foreign investment to his company, which leads to improved firm performance.*

One academic respondent supported the view of the regulator (AC2)

> *The family board members have a positive effect on the firm performance ... simply because his family own the largest shares in the company, which gives him more responsibility towards the company's assets. Also, when a family member becomes the CEO of the company, it gives him a close relationship with the family members, which leads to confidence of the family and increasing the firm's performance in the long-term.*

In summary, the majority of participants felt that the relationship between the family board member and firm performance is positive. Some supported this view because a family member would be more careful about family investments and have a desire to increase the firm's performance. In addition, in family businesses, a CEO from the same family has the ability to be a good leader and understand the business's activities.

8.4.1.4 BOARD OF DIRECTORS SUB-COMMITTEES

In this section, the researcher asked questions related to the board sub-committees. The majority of participants believed that the board of directors needs to delegate certain duties to sub-committees in order to assist in the financial auditing process (the audit sub-committee) and to appoint, encourage, and obtain suitable members with specific experience and qualifications for the board of directors (the nomination and remuneration sub-committee). The participants mentioned that Saudi listed companies mostly had the audit, and nomination and remuneration sub-committees. However, a number of companies have additional sub-committees such as risk, investment and finance, *sharia*, and corporate governance sub-committees. Each has particular duties and responsibilities; for example, the investment and finance sub-committee assists the board of directors in making good feasibility investment decisions, while the *sharia* sub-committee evaluates the financial transactions from an Islamic perspective.

Most of the interviewees considered the audit sub-committee as very important and that the members of this sub-committee should be non-executives and have a background in accounting and auditing. The nomination and remuneration sub-committee and the executive sub-committee were considered to less important than the audit sub-committee. One chairman of a listed company stated (CH1)

> *The most important sub-committee is the Audit sub-committee, which has a vital and important role to check the financial reporting in accordance the accounting standards. … Also, in our company, I head the Audit sub-committee, and I have a background in accounting and auditing. … The Audit committee is required by the Ministry of Commerce and Industry before the existence of the regulation of corporate governance in Saudi Arabia.*

One non-executive member concurred (NEXE2)

> *I think it is a good sub-committee [Audit Subcommittee]. [It is] dependent on some conditions such as … needing members who have a background in accounting, finance, and auditing, and giving the members full authority and responsibility to work with and check financial reporting. Also, in my opinion,*

why not invite an external auditor to work with us as a non-executive member to take his experience and knowledge in the auditing process.

In addition, a number of interviewees mentioned that members should be non-executive for the audit, and nomination and remuneration sub-committees and that there should be at least one executive member on the executive sub-committee. Furthermore, the background of the members of the sub-committees is very important regarding putting the right member in the right sub-committee. One non-executive member claimed (NEXE2)

When we talk about increasing the firm performance of the company, the sub-committees must be filled with suitable members who have backgrounds in the particular field such as accountants in the Audit sub-committee, human resources in Nomination and Remuneration. These criteria are very important to fill the position with the right person. I am sure when we put the right person in the right place, then we get positive performance.

Another view of the participants is that sub-committees have clear roles and definitions to act according to best practice and mitigate conflict among members. Furthermore, to ensure high quality sub-committee performance, the board of directors should appoint just one or two members in the each sub-committee to reduce conflict among members and enable good decision-making. As one shareholder said (SH2)

I think that the company just needs one person with an accounting and auditing background to act in the role of the Audit committee. No more because just we need the right person give the board of directors the right opinion about accurate financial reporting. We need two people to fill positions in the Nomination and Remuneration sub-committee. I suggest this to get positive performance of the company and reduce conflict among members inside the sub-committees.

The CEO of one of the listed companies added (CEO1)

I think the subcommittees of Audit and Nomination and Remuneration are critical and reflect the firm's performance. The Nomination and Remuneration sub-committee reviews the structure of the board of directors, providing the

> *board of directors with skills that they need, and determining the strong and weak points of the board members. ... For these reasons, I think Nomination and Remuneration has a critical role which leads to increasing firm performance. Also, the Audit sub-committee has an important role to review the internal audit report and accounting standards used in the financial reports, allowing disclosure of high-quality financial information to attract investment to the company (CEO1).*

In summary, the participants suggest that all the listed companies have three kinds of sub-committees: audit, and nomination and remuneration, and executive committee. The interviewees mentioned that the majority of the sub-committee members must be non-executive and have backgrounds related to the function of the sub-committee, which means appointing specialized members in order for performance to be of high quality.

8.4.1.5 ROYAL FAMILY BOARD MEMBERS

The researcher investigated this variable in order to examine its effect on how the organization operated work and how it can affect firm performance. Having a board member from the royal family is a regular feature of corporate life in monarchical countries such as Saudi Arabia and other Gulf countries. There are a number of companies listed in the capital market with royal family members—some as chairman and others as non-executive members. As one shareholder maintained (SH3)

> *I think the existence of the royal family member on the board of directors gives the company a good reputation and attracts investment to the company. I am one of the investors who invested my money in a company with a royal family member.*

A board secretary of a joint-stock company concurred (SEC1)

> *I would like to say something will be surprising: Some companies invite board members from the royal family just for his name, no more, to attract more investment and build the brand name in the market.*

However, a number of the participants believed that royal family board members play a significant role because they have large investments in the companies and are very careful about their shares. Furthermore, the royal family member may monitor and control the management more carefully. The existence of a royal family member on the board of directors gives the company a good reputation, pushes the company to a competitive market, and attracts local and foreign investment in the company. Thus, one chairman claimed (CH1)

> *I strongly agree. The existence of a royal family member on the board of directors motivates us to give the company maximum effort, because this member has a large portion of the company shares. Honestly, the existence of this kind of member leads to increased firm performance because, simply, if he doesn't see any dividends or advantages of this company, he will withdraw his investment from this company.*

However, one non-executive member put forward a more nuanced argument (NEXE2)

> *This is a very difficult question. I think there are many factors, such as the skill and experience of the royal family board member, which may affect positively or negatively. Add to this point, does the royal family member have a large number of shares or is he just a non-executive member? If the family board member acts as a non-executive member and also owns a large portion, in my view, I think he has a positive effect on firm performance. In contrast, if the royal family member acts as a non-executive without owning significant shares, it may lead to bad performance because maybe this member doesn't have any skills or experience to give the company more reputation.*

In short, the participants did not perceive that all royal family members play a vital role on the board of directors. The interviewees mentioned that only royal family members who hold large shares have a vital role and the power to increase investment in the company, leading to better performance. Other kinds of royal family members—those who act as non-executives just to give more attention to a particular company—do not guarantee a good performance.

8.4.2 OWNERSHIP STRUCTURE

This section focuses on the ownership structure in Saudi listed companies. The researcher asked questions about majority ownership in listed companies and how these ownerships affect firm performance. The results reveal that the ownership structure in the listed companies depends on the industry sector; for example, most service companies are owned by the government. The majority of shares in a family business are owned by the family. Furthermore, the majority of participants indicated that a large or concentrated ownership—whether managerial, family, government, foreign, financial firm, non-financial firm or distributed ownership—leads to a good corporate governance system in the company. For example, one chairman argued (CH2)

> *The good corporate governance system in the company leads to attracting more large investments, whether from family or firms or any kind of the large ownership. This is because this large ownership will get greater protection with the good corporate governance system; also, the small shareholders will join this company because it has a good governance system that separates between ownership and management.*

The interview data shows that the majority of large shareholders are non-financial firms', family and the government. The participants believed that the three types of large owners have strong roles in increasing firm value and can affect firm performance in a positive way. Thus, one regulator stated (R1)

> *Most of the large majority ownership in the Saudi capital market is government and family ownership. I think it is good, because this give the company more motivation to implement a good corporate governance system, and the good corporate governance system means good performance. Also, I can confirm that most companies that have these types of the large shareholders have less irregularities and implement the regulations of the corporate governance that are issued by the Capital Market Authority ... that is what I mean by a good corporate governance system.*

Another view of participants is more pessimistic. Those interviewed suggested that not all large shareholders play a good role in the company. Some large shareholders are believed to be opportunists and, unfortunately, Saudi Arabia does not have a system that protects minority shareholders. As one shareholder stated (SH3)

> *In my opinion, any company dominated by groups of shareholders, particularly families or any groups of friends, gives me a pessimistic view about this company, and I think this company is under risk because this type of large*

> *shareholder includes more opportunists and just thinking about their interests and use the firm's assets in the wrong way and to their benefit. Also, unfortunately, we don't have a system to protect the minority shareholders, which leads to these groups to act as managers and shareholders, no separation, and they just look at their interests.*

In addition, the existence of the government ownership in a company indicates that this firm has a good long-term plan, good feasibility studies, and also a good corporate governance system. The existence of this kind of ownership attracts more investors and reassures minority shareholders. One government representative on a board of directors in a listed company argued (GOV1)

> *Trust with full confidence ... the government invests money in the good companies which have a good long-term plan, good feasibility studies and, also, they haven't any irregularities with the* Capital Market Authority*. Moreover, the government seeks to improve infrastructure and increase welfare of the citizen, which lead to improve firm value.*

Furthermore, one CEO of a joint-stock company explained (CEO1)

> *In our company, the government own more than 12 percent of our shares and also, we have one of the government institutions sitting on our board of directors. I would be very honest with you, the existence of the government ownership in any company draws the attention of minority shareholders, and is useful for the shareholders look at the long-term investment to invest their money in this type of company and to get dividends at the end of every year.*

In relation to the relationship between ownership structure and firm performance, the data shows that participants have mixed views. Some participants stated that the relationship between ownership structure and firm performance is positive, while others thought it is negative, and a large group of participants stated that the relationship between ownership and performance depends on the type of ownership. As one non-executive stated (NEXE1)

> *I think it may be take two impacts depending on the type of the large shareholders, industry type, and the period of the investment (short-term or*

long-term). In my opinion, it depends on the type of the large ownership. If the large ownership is government, family or individual, I think the impact will be positive, because the government bodies act as a support for these companies to enhance the firm performance which leads to improving the capital market. Also, add to your mind the family or individual ownership just put their money in the good companies that have a good and clear corporate governance system, which separate[s] between ownership and management to ensure that their investment is safe. On the other side, I think the non-financial firms' ownership has a negative impact on firm performance, because they want to control the company for their interests.

Furthermore, some interviewees believed that large shareholders have a negative impact on firm performance. These participants felt that large shareholders destroy a firm's value and performance by receiving expensive gifts, such as tickets and travel packages. One academic researcher asserted (AC1)

I would like to say something secret: There is one of the company in Saudi Arabia that has no competitor and just this company provides this service [LAUGH]. I think you know which company I mean. This company pays dividends in fixed amount for three or four years to the shareholders—is this logical! ... add to this, this company pay large salaries to the executive management and also, provides significant gifts and packages to the large shareholders and non-executive members. Now, I will ask you, what do you think about this company performance!!! Let me answer ... absolutely, this company has a negative performance.

More input came from an auditor who, stated (AU1)

In the Saudi capital market, we have five types of the large ownership: government, family, financial firms, non-financial firms, and foreign ownership. All of these are concentrated in specific companies. Some companies have positive [effects] and others have negative [effects]. For example, the government ownership may be found in some companies as a positive impact on firm performance and on other companies as a negative impact; actually, there are no clear roles. However, in my experience, the family and government *ownership have a positive impact in general; and the foreign ownership, there is no impact until this time because there are not many foreign owners in the Saudi capital market, but, I think, in the near future, it will be a positive impact on the firm value and performance.*

Overall, the relationship between large owners and firm performance is ambiguous. Sometimes, large ownership is believed to have a positive impact on firm performance and other times a negative impact. Furthermore, in some cases, large ownership may have no impact at all. In addition, the participants stated that the nature of the relationship depends on industry type, the portion of the large shareholders, and the type of large shareholder. The majority of the study's participants agreed that family or individual ownership has a positive impact on firm performance. In addition, government ownership is also believed to have a positive impact on firm value, enhances the economy of the nation, and leads to better service for customers.

8.5 SUMMARY

This chapter presents the results obtained from the second research method, semi-structured interviews which were conducted with 17 participants who were members of boards of directors, shareholders, regulators, auditors, academics, and government representatives. The main objective of the interviews was to explore the current corporate governance regulations in Saudi Arabia. The researcher used semi-structured interviews to support the results of the annual reports (a quantitative approach) and examine the relationship between corporate governance mechanisms and firm performance. The objective was to gain a deeper understanding about this relationship by obtaining opinions from various stakeholders. The main subjects covered in these interviews were: understanding corporate governance in Saudi Arabia; evaluating the current corporate governance regulations; examining the relationships in corporate governance mechanisms by focusing boards of directors, ownership structure, and firm performance as variables.

The research analyses two corporate governance issues: the definition of corporate governance, and the importance of the corporate governance regulations in Saudi Arabia. In defining corporate governance, interviewees were divided into two main groups. The first group focused on the internal process of corporate governance with an eye to the boards of directors as the people who protect shareholders' interests. The second group looked at corporate governance as an issue of social responsibility for all stakeholders. However, all interviewees agreed that corporate governance has an important role in the business environment. Its importance was reflected in the emphasis on protecting shareholders and other stakeholders, achieving fairness and equitability, and attracting foreign investment. All these objectives result in improved firm performance and a stronger national economy.

Most participants agreed the first draft of the corporate governance regulations is generally good. However, these regulations need more detailed explanation in order to facilitate comprehension. Participants noted that the regulations need to be taken more seriously by the boards of directors, and also pointed out the need for disclosure and transparency to help investors make good decisions. There were a number of participants who suggested that the CMA issue new regulations and codes dealing with non-executive members and internal control systems, which would also give investors greater confidence. The participants mentioned difficulties applying corporate governance practices due to a lack of awareness on the part of investors and other stakeholders, and also noted the costs and time of implementing the regulations.

The researcher asked questions related to quantitative data on corporate governance mechanisms and firm performance. Important variables considered in this study are the size of the boards of directors, non-executive members, family board members, boards of directors' sub-committees, royal family board members, and ownership structures. Regarding the size of the boards of directors, interviewees recommended considering quality over quantity, though a number of participants suggested that boards should have between eight and ten members of various backgrounds and experience. There is no requirement to appoint non-executive members; however, the majority of participants suggested that non-executive members should have experience and knowledge related to the industry type. Most participants felt comfortable with family members joining boards of directors because they have a responsibility to maintain company performance and therefore family investment. The sub-committees were felt to play a vital role in assisting the boards of directors by delegating functions. The members of sub-committees should be non-executive, qualified members related to the main function of the sub-committee. The participants believed that a royal board member would have a vital role if he had a large share in the company.

There are many ownership types in the Saudi stock market, including family ownership, non-financial ownership, financial ownership, government ownership, and foreign ownership. The type of ownership is closely related to the industry type. For example, the majority of financial and insurance businesses are owned by banks and other financial firms and the majority of service sector businesses are owned by the government. The relationship between ownership structure and firm performance depends on the type of the ownership, and the type of industry. In some cases the relationship has a positive effect, but in other cases it has a negative effect and sometimes the relationship between ownership and firm performance has no effect. The majority of participants agreed that family, government, and non-financial ownership have a positive effect on firm performance. In addition, a number of participants suggested that financial firms play a vital role and have a positive impact on firm performance for bank and insurance companies listed on the Saudi Capital Market.

9 GENERAL DISCUSSION

9.1 INTRODUCTION

The main objective of this chapter is to integrate the quantitative and qualitative analysis and explain the findings of this study. This study uses qualitative data to support the quantitative (secondary) data and also to cover points not covered by the quantitative data. This chapter combines the results of the two approaches to describe the relationship between corporate governance mechanisms and firm performance, which is the focus of the main research question.

9.2 DEFINITIONS OF CORPORATE GOVERNANCE

Before 2006 there was no attention paid to corporate governance and to the protection of shareholders in Saudi Arabia (Falgi, 2009; Alshehri, 2012). Most shareholders were fully satisfied with the Saudi stock market because they made significant profits in a bull market with the share index peaking at over 20,000 in February 2006 (Alshehri, 2012). In this situation, the stakeholders (particularly shareholders) were not giving any attention to investor protection and the importance of corporate governance; they also had the view that the market 'did not need corporate governance because we reap profits!!' Unfortunately, the investors had forgotten the financial crisis that happened in Kuwait—the Al-Manak crisis of the late 1970s—because of the absence of regulations and the lack of legal protection for the shareholders (Al-Saidi, 2010). After the Saudi stock market crash in February 2006, known locally as Black February (Falgi, 2009), investors, academics and other stakeholders demanded that regulations be issued to protect the interests of shareholders and other stakeholders, such as banks, suppliers and employees.

The concept of 'corporate governance' was not understood in the Saudi business environment in the event of the crashing of the Saudi capital market, and the Arabic terms *Hawkamat Alsharekat* and *Aledarh Alrasheedah* were more generally used in the Saudi media (Alshehri, 2012). This study discovers that the Corporate Governance Unit in the Capital Market Authority (CMA) officially uses the term *Hawkamat Alsharekat*, which is in line with Falgi (2009), who concludes that the official term used by the CMA is *Hawkama*—this term was chosen by stakeholders as the most appropriate Arabic term for referring to 'corporate governance'. Falgi (2009) argues that using *Hawkama* helps to increase awareness of corporate governance, is easy to communicate, and produces greater understanding among various stakeholders, which leads to increased accountability.

Because of this confusion of terms, there is no agreement on the meaning of corporate governance in Saudi between among the various stakeholders, whether they are board of directors, shareholders, or other stakeholders such as bankers, suppliers or regulators. Thus, each stakeholder holds a different view of the definition of corporate governance; for example, the definition may differ among the board members, depending on the types of role (executive or non-executive), and also among the shareholders (majority and minority). Each group of stakeholders looks at corporate governance through its own lens; stakeholders are interested in the advantages that they can gain from corporate governance. However, in general the definitions can be divided into two, a narrow and a broad view.

A number of interviewees in this study defined corporate governance as a system governing how the company is managed and controlled via the board of directors in order to support investors' interests. This definition is a narrow one, which concerns only two stakeholders—the board of directors and shareholders—while ignoring others stakeholders and other functions and benefits of corporate governance. This view of corporate governance is in line with Sir Adrian Cadbury (1992, p. 7), who defines corporate governance as "the system by which companies are directed and controlled". This definition, which is based on an agency perspective, focuses on the internal process of corporate governance and is concerned with the responsibilities of the board of directors to manage the company using the best practices to protect the shareholders' interest, which is based on agency perspective.

On the other hand, a number of participants viewed corporate governance more broadly, with greater emphasis on all internal and external stakeholders in the company and their level of accountability. This view is consistent with Solomon, who defines corporate governance as "the system of checks and balances, both internal and external to companies, which ensure that companies discharge their accountability to all their stakeholders and act in a socially responsible way in all area of their business activity" (2010, p.6). This view is a broader perspective based on stakeholders' perspectives and the accountability of a wide variety of internal or external groups related to the company.

Thus, both views are correct and true. Both views' groups try to define the term 'corporate governance' from their own positions and interests. However, both of these groups agree with Hussain and Mallin (2002), who stated that the definition of corporate governance reflects the following ideas:

- Provides a system of controls within the company.
- Sets the relationship between board of directors/shareholders/other stakeholders.
- Means the company is being managed in the interests of both shareholders and stakeholders.

9.3 THE IMPORTANCE OF CORPORATE GOVERNANCE REGULATIONS

According to Claessens (2006), there are a number of factors that have resulted in corporate governance gaining greater attention in developing economy:

1. Privatization.
2. Liberalization and opening up of financial market.
3. An increasing number of listed companies and a growing number of institutional investors in many countries.
4. Deregulation and reform reshaping the local and global financial landscape.
5. Increasing international financial integration and investment.

All these factors are present in Saudi Arabia, which highlights the importance of corporate governance regulations in the Saudi business environment. The participants in the study suggested that the existence of corporate governance regulations give the shareholders a greater level of comfort about their investment. This is because of the perception that the existence of good corporate governance regulations ensures a decrease in investment risk and lower levels of company corruption. Arguably, if corporate governance regulations had existed during the Black February crisis the level of the investment risk and company corruption might have been lower. Investment risk will also be helped by the fact that a good corporate governance system should lead to enhanced firm performance and efficiency. Good firm performance will not be achieved without applying good codes and standards of corporate governance.

Furthermore, there are a number of families, individuals and large corporations that own a significant number of shares in many listed companies in the Saudi capital market. These types of owners tend to be look for their own interests at the expense of minority shareholders. For that reason, the separation of ownership and control is one of the most important aspects of corporate governance, in order to ensure the protection of minority shareholders' interests.

Furthermore, the Saudi stock market is one of the more active markets in developing countries, which attracts foreign investors; therefore, the existence of good corporate governance regulations becomes even more important. In addition, the existence of corporate governance regulations in the Kingdom of Saudi Arabia should lead to enhancing the macroeconomic environment and building a strong picture of a trustworthy capital market.

9.4 THE EVALUATION OF CURRENT CORPORATE GOVERNANCE REGULATIONS

One of the research objectives of this study is to evaluate the current corporate governance regulations. The current corporate governance regulations give the listed companies' guidelines without providing in-depth details. Most of the participants agreed that the current regulations just provided outlines without details, and participants need more explanation and details about the codes and regulations to apply them in the right way and to avoid irregularities. The majority of interviewees demanded that the Saudi Capital Market Authority issue the manual written in the simplest language to understand the current regulations for all stakeholders. In addition, most of the participants asked that the Saudi Capital Market Authority establish some courses and seminars to explain these regulations in many cities of the Kingdom to increase the awareness and knowledge among different stakeholders. Furthermore, most of the participants suggested that the Capital Market Authority should be following the United Kingdom to issue some regulations that discuss special elements, such as the Higgs Report, which regulates non-executive directors in the UK, or the Turnbull Report, for internal control.

Most participants considered disclosure and transparency to be some of the elements most needed to be improved and developed. These two elements are very important and have a vital role in increasing investments in the company, attracting foreign investors and improving the reputation of the Saudi capital market. Most of the local or foreign investors focus on these two elements when they need to make a decision about investing in the company. Disclosure and transparency were mandatory requirement from the Ministry of Commerce and Industry (MOCI) before the Capital Market Authority was established. According to Al-harkan (2005), the MOCI in Saudi Arabia confirmed the sufficiency of all information and data related to financial statements and operations in order to help shareholders assess firms' performance and make good investment decisions. Nowadays, when increasing the number of companies listed in the Saudi capital market, because most of the listed companies have a website, they need to improve disclosure and transparency among their online services. The participants suggested that there is a lack of disclosure related to the board of directors' mechanisms, such as the requirements for appointing non-executive members. The Saudi listed companies need to disclose clearly how well appoint these members. Also, the Capital Market Authority needs to be stricter with listed companies regarding board sub-committees, such as the audit, remuneration and nomination committees, because some listed companies just establish these committees and mention them in the board of directors' reports to meet the mandatory Capital Market Authority guidelines, without any disclosure about what type of functions they perform. The most important idea is to develop disclosure and transparency, particularly in reports by boards of directors. A lack of information and the cost of implementing corporate governance systems are the issues most directly related to successfully applying a corporate governance system in the Saudi Arabian business environment.

There is good news: a number of the listed companies have set up their own corporate governance regulations derived from the OECD principles of corporate governance. These companies applied the principles of corporate governance unofficially before the Capital Market Authority issued its codes at the end of 2006, which gave them more ability to apply the regulations to comply with all codes when the Saudi regulations were issued in 2006. These companies use the Saudi regulations as their main codes and regulations, and modify some regulations in more detail, such as the internal control report, non-executive director report and audit committee report, to facilitate the organizational work in order to provide the investors a greater level of comfort with their investments.

In addition, a number of the participants stated that to improve the current regulations of corporate governance in Saudi Arabia, the Saudi Capital Market Authority should invite foreign members from international bodies, such as the OECD, UK and US agencies, to develop the current regulations to reach the best practices. The expertise of foreign members would provide the Capital Market Authority the knowledge and experience necessary to improve regulations in regards to appointing nonexecutive members, setting the functions and establishing the membership of sub-committees, and setting salaries and bonus levels for executives, particularly those in family businesses—as well as to create some regulations related to the large bodies of ownership, such as families, individuals and corporations.

The majority of the participants mentioned some difficulties and obstacles that interfere with corporate governance practices in the companies. One of these difficulties is stakeholders' lack of awareness. This obstacle arises from misunderstanding the objectives of the corporate governance regulations. Another difficulty arises from the corporate governance regulations being costly and lengthy to implement. Currently, the Saudi Capital Market Authority has committed the listed companies to establishing their own corporate governance regulations based on the main regulations from the Capital Market Authority. Actually, this obligation will be costly and will take more time, which demands that the listed companies invite experts to help establish the regulations of the company; this expertise also will be expensive and will take more time.

9.5 THE RELATIONSHIP BETWEEN CORPORATE GOVERNANCE MECHANISMS AND FIRM PERFORMANCE

The primary objective of this study was to examine the relationship between corporate governance mechanisms and firm performance in the companies listed in the Saudi Capital Market. To achieve this objective, this study started by providing an overview and understanding of the corporate governance concepts and evaluating the current regulations as a prelude to studying the main objective of this research which is an examination of the effect of corporate governance mechanisms on firm performance. To achieve the main objective, this study used secondary data from the annual reports of the companies listed in the Saudi capital market. The researcher applied three regression techniques; namely, OLS, 2SLS, and GMM. After that, the researcher used semi-structured interviews to support the results of the secondary data and gain a better understanding of the nature of the relationship between corporate governance mechanisms and firm performance from various stakeholders such as board members (executive, non-executive and chairman), regulators, auditors, academics, shareholders, and representative members of government. The researcher asked several questions about the mechanisms of the board of directors and ownership structure in the listed Saudi companies and how these mechanisms affect firm performance.

This section will compare the results of quantitative data (secondary data) and qualitative data (semi-structured interview data). In this study, corporate governance mechanisms were divided into two main variables. The first variable is board structure, which consists of board size, non-executive members, family board members, royal family board members and board committees. The second variable is ownership structure, which consists of managerial ownership, family or individual ownership, government ownership, foreign ownership, financial ownership, and non-financial ownership.

9.5.1 Board of directors' structure

9.5.1.1 Board size

A large body of research examines the structure and effect of board size on firm performance. Empirical studies on the relationship between board size and firm performance have produced mixed results. Much of the literature on board size has called for small boards (Lipton and Lorsch, 1992; Jensen, 1993; Coles et al., 2008). These arguments are based on the notion that small boards are more cohesive, more productive and are better able to monitor the firm more effectively. The literature reveals that larger boards produced a number of problems such as social loafing and higher co-ordination costs (Coles et al., 2008).

However, some scholars preferred the larger board. Dalton et al. (1999) summarized the advantage of the larger boards, which provide a firm with larger internal budgets, external budgets, and leverage (Pfeffer, 1972, 1973; Provan, 1980). In addition research on board interlock prefers larger boards for their ability to produce more information and their higher levels of experience and, therefore, ability to achieve positive corporate outcomes (Bazerman and Schoorman, 1983; Burt, 1980).

The average number of board members in the companies listed in the Saudi capital market is eight, which is consistent with Jensen (1993). According to Jensen (1993), the optimal size of a board of directors is seven or eight members and, when a board is larger than this number, it is less likely to function effectively as well as easier for the CEO to control. Vafeas and Theodorou (1998) studied the relationship between board structure and firm performance in 250 publicly traded firms in the UK; the mean board size of their study was 8.07, which is the same mean as the Saudi companies listed in the Capital Market.

Regarding the three regression techniques, the current study found a positive relationship between board size and firm performance based on the ROA. However, after controlling for the endogeneity problem, the relationship is still positive with high significance. This result supports some of the previous studies (Loderer and Peyer, 2002; De Andres et al, 2005; Haniffa and Hudaib, 2006). For instance, Haniffa and Hudaib (2006) reported a statistically significant and positive relationship between board size and ROA among 347 companies listed in Kuala Lumpur for the period 1996 to 2000. This study grew out of research by Zahra and Pearce (1989), who suggested that large board size related positively to company financial performance: they found a positive relationship and assumed a large board size to have directors with diverse backgrounds, skills and experience.

Our result is inconsistent with agency theory, which states that the relationship between board size and firm performance is negative; see Yermack (1996) and Eisenberg et al. (1998). However, this study result is consistent with resource dependence theory. This theory is based on Pfeffer and Salancik (1978), who stated that "when an organization appoints an individual to a board, it expects the individual will come to support the organization, will concern himself with its problems, will variably present it to others, and will try to aid it" (p. 163, as cited in Hillman and Dalziel, 2003). Pfeffer and Salancik (1987) and Hillman and Dalziel (2003) stated that the resource dependence theory prefers larger board for some benefits such as advice and counsel, channel for communicating information between external organization and firm, and preferential access to commitments or support from important elements outside the firm.

On the other hand, the present study found an insignificant negative relationship between board size and Tobin's Q. The main reason for this result is consistent with investors' belief that board size does not matter for future performance, perhaps because investors think that the board size is not an important aspect of corporate decision-making governance and, instead, focus on quantity, not quality. The actual effect on performance appears in the ROA, but the investors' belief that board size is irrelevant would lead to no statistical significance in Tobin's Q for the near future.

The interview results supported the quantitative regression results that are related to the board size. The main findings are that board size does not matter in the Saudi Arabia at the present time, and this view is concerned with the quality of the board members rather than quantity, which is consistent with the Tobin's Q results. The second finding is that a large board is more suitable for the listed Saudi companies (the resource dependence theory) but should nevertheless be limited to seven or eight members (the view of Jensen, 1993) with various backgrounds in order to establish a high-quality board of directors as well as increase and enhance firm performance. Most of those who support the second view agreed that it might be advisable to establish a large board in the first stage to develop and improve the company; and, afterward, when the company reaches its target, it should reduce the number to a size that is more suitable for the firm's size while maintaining the quality of the board members. However, the impact of board size on performance is expected to differ from some firm-specific characteristics and may also vary between countries (Guest, 2009).

9.5.1.2 Non-executive members

Outside non-executive members on the board of directors serve an important function: they select CEOs, as well as monitor and reward or punish managers (Agrawal and Knoeber, 2001). Some theories, such as agency theory, stewardship theory and resource dependence theory, explain the role of non-executive members and their effect on the firm's performance. According to Walsh and Seward (1990) (as cited in Peng, 2004), to mitigate agency problems, outside non-executive members must be independent relative to the insiders. In addition, they may be able to do a better job at monitoring and controlling management, which leads to improve firm performance. Therefore, it is very difficult to describe family members who serve on the board, even if they are not employees, as fully independent in a family business or any listed company which a family owns significant shares. Resource dependence theory predicts that highly resource-rich outside directors will be placed on boards to help bring in needed resources, which leads to better performance. In addition, stewardship theory suggests that non-executive members have less knowledge about the business; therefore, they will have difficulty understanding the complexities of the firm (Weir and Laing, 2000) (as cited in Ntim, 2009). Resource dependence and stewardship theories are more suitable for the listed Saudi companies, because most of the non-executive board members are rich and wealthy people and, perhaps, are neither knowledgeable about nor experienced with the firm, particularly after they are first appointed to the board.

Empirical studies on the relationship between non-executive members and firm performance have produced mixed results. In this study, which generated three technical regressions based on the ROA, we found an insignificant relationship between non-executive members and ROA. This result supports the findings of Haniffa and Hudaib (2006), who found non-executive members not to be significantly related with ROA. In Saudi Arabia, for certain non-executive members (who do not represent a family ownership) to sit on a board of directors, the individual should own at least 1000 shares in the company, which does not give the non-executive too much power over the company. However, based on the 2SLS and GMM after controlling for endogeneity, we found a significant negative relationship with ROA that is supported by the stewardship theory. This result indicated a negative relationship even when the past performance was controlled. Our result is consistent with Ntim (2009), who found a negative relationship between a non-executive board member and ROA when financial performance lagged; he found the same result for the non-executive members as we did.

According to Tobin's Q, this study did not find any significant relationship in all regression techniques. This result is consistent with investors' belief that non-executive members do not matter to future performance because investors expect that non-executive members do not have enough experience or power to monitor firms' best practices. However, with the dynamic GMM model, which uses two lags of the Tobin's Q as a control factor, we found a highly positive significant relationship between non-executive members with Tobin's Q, which indicates an interesting sign flip (from negative to positive) and explains the bias that may arise from ignoring the unobservable heterogeneity and dynamics related to past performance. The dynamic GMM detected this unobservable heterogeneity.

The interview results support exactly what happened with the regression analysis. Some of the participants stated that some of the listed companies appointed a non-executive who is a wealthy person and who has a good relationship with large shareholders but does not have enough experience or knowledge to monitor the company, which leads to bad corporate performance. In addition, the lack of clear requirements for appointing the non-executive members in the listed companies contributed to negative effects on firm performance.

9.5.1.3 Family board members

Family board members are very important elements in the Saudi business environment. A large number of family members sit on the boards of directors of companies listed in the Saudi capital market. Fama and Jensen (1983, p. 306) proposed that "family board members have many dimensions of exchange with one another over a long horizon and therefore have advantages in monitoring and disciplining related decision agents", which means that the costs of monitoring are less for family board members than for other members (McConaugby et al., 2001). However, family board members may be dangerous: they may promote leadership irresponsibility, expropriate from minority shareholders, cause hubris, and take excessive risks (Miller and Breton-Miller, 2006). According to Al-Saidi (2010), family board members may produce several problems such as family instability, lack of planning, problems with succession, nepotism, and favouritism that may negatively affect firm performance.

In this study, the three technical regressions based on the ROA, yield a statistically significant and positive coefficient on the presence of a family board member on ROA. This result supports some previous studies, such as Maury (2006) and Sanda et al. (2005), and indicates a positive relationship between family board members and firm performance. This positive relationship shows that families have power as well as good access to corporate information, which leads to good firm performance (Al-Saidi, 2010). Miller et al. (2013) argued that firms run by family board members (executives or non-executives) who are closely associated with their business often had useful information and knowledge about their businesses, which led to enhanced firm performance compared to firms that do not have family board members.

On the other hand, this study did not find any significant relationship in any of the regression techniques that examine the relationship between family board members and Tobin's Q. The main reason for this result is, again, consistent with the view of investors who believe that family members do not matter to future performance because investors expect that the family members do not play a vital role in monitoring the firm's best practices and because there may not be much variation in practice in the explanatory variables in the case of Saudi Arabia. However, dynamic GMM model, which uses two lags of the Tobin's Q as a control factor, we found a highly negative significant relationship between family members with Tobin's Q, which once again indicates an interesting sign flip and explains the bias that may arise from ignoring the unobservable heterogeneity and dynamics related with past performance. As noted previously, the dynamic GMM detected this unobservable heterogeneity.

The interview results interpreted what happened with the quantitative results. Most of the participants mentioned a positive relationship between a family board member and the firm's performance. This positive relationship occurs when the family board member cares about the family's investment and reputation. This loyalty enhances and increases the firm's performance. In addition, when a CEO came from the same family that owned a large share in a company, it enhanced his ability to be a good leader and understand the business's activities, as well as be more careful about the family investment, which led to increased company performance.

9.5.1.4 Royal family board members

Some of the companies listed in the Saudi capital market have one or more members of the royal family sitting on their boards of directors. Royal members have a powerful and good informal network, which may help increase the firm’s performance. According to Alghamdi (2012, p. 58), many members of the royal family in Saudi Arabia are appointed as directors of boards and serve on boards as managerial members; therefore, they may monitor the management closely, thereby decreasing possible mismanagement and wrongdoing. According to Alghamdi (2012), the presence of royal members on the board might increase a firm’s value because most of them sit on the board as owners, which improves the firm’s performance.

The author of the present study applied three regression techniques to examine the relationship between royal family board members and firm performance; the results found a positive relationship between royal family board members and firm performance. However, the results after controlling for endogeneity, which depends on the GMM, found a negative relationship between royal family board members and firm performance. The sign flip is interesting and explains the bias that may arise from ignoring the unobservable heterogeneity and dynamics related with past performance. The dynamic GMM detected this unobservable heterogeneity.

The interview results partly supported the quantitative results: the majority of participants did not think that all royal family members play a vital role on the board of directors. The interviewees mentioned that only royal family members who hold large shares have a vital role and the power to increase investment in the company, leading to better performance. Other kinds of royal family members—those who act as non-executives just to bring more attention to a particular company and give the company a good reputation—do not guarantee that the company has good performance.

9.5.1.5 Board of director sub-committees

According to Saudi Regulations of Corporate Governance (2006), a number of suitable sub-committees may be set up in accordance with the company’s requirements to enable the board of directors to effectively perform its duties. According to the Saudi Regulations of Corporate Governance (2006) by-laws, the board of directors may set up two main sub-committees—the audit committee and the nomination and remuneration committee—and the majority of the members in the sub-committees should be non-executive members.

The relationship between board sub-committees and firm performance has not escaped the researcher's notice and is still in an embryonic stage (Dalton et al., 1998; Ntim, 2009). According to Ntim (2009) limited studies are concerned with board sub-committees in developed markets, which makes this variable important to future research, especially within emerging markets.

This study found an insignificant relationship between board sub-committees and firm performance. However, after controlling for endogeneity and applying the dynamic GMM, the board sub-committees took two paths. The results that depend on ROA (backward-looking) were highly positive significant. In contrast, the Tobin's Q (forward-looking) achieved highly significant negative results. These two opposite results indicated that maybe the Saudi capital market will be changing some of the regulations that relate to board sub-committees in the future that lead to a negative relationship and low market valuation in the first stage; then, when the regulations are better understood and more reliable, they will lead to a positive effect on firm performance.

The interview results mentioned that the majority of the subcommittee members must be non-executive and have backgrounds related to the function of the sub-committee, which means appointing specialized members who are capable of high-quality performance. The interview results also mentioned that, to get high quality sub-committee performance, boards of directors should appoint just one or two members in the each sub-committee to reduce conflict among members and make good decisions. The outlook of both results (quantitative and qualitative) indicated that the listed companies may have appointed non-qualified members to their sub-committees. This suggest that some companies still regard board sub-committees as a excercise compliance rather than as providing beneifits for companies.

9.5.2 Ownership structure

9.5.2.1 Managerial ownership

Managerial ownership, or internal ownership, is one of the most important ownership structures in a company. Jensen and Meckling (1976) argued that, if managerial ownership decreases, the agency cost will be generated by divergence between the manager's interests and the interests of outside shareholders. Crutchley et al. (1999)'s agency theory suggested that the agency cost may be reduced if managers increase their common stock ownership of the firm to better align their interests with those of outside shareholders. According to Dinga et al. (2009), two main hypotheses describe the relationship between managerial ownership and firm performance: the convergence of interest hypothesis and the entrenchment hypothesis. The convergence of interest hypothesis proposes that the equity ownership of managers aligns the interests of shareholders and managers; and, when the proportion of equity owned by managers increases, the interests of both parties (managers and outside directors) align (Dinga et al., 2009; Ntim, 2009). However, another hypothesis, the entrenchment hypothesis, views the situation differently. According to Morck et al. (1988), a high level of managerial ownership may lead to entrenchment, which makes it difficult for outside shareholders to monitor the firm (as cited in Short & Keasey, 1999).

A large body of work examined the relationship between managerial ownership and firm performance and produced mixed results because of the problem of multicollinearity between managerial ownership and family or individual ownership. The researcher of present study applied OLS with three models; the first one regressed both managerial ownership and family or individual ownership, the second regressed just managerial ownership without family or individual ownership, and the third model regressed family or individual ownership without managerial ownership. Our results that related to managerial ownership based on ROA were positive and remained the same after controlling for endogeneity and using a dynamic GMM that controlled through both one and two lags of ROA. This positive coefficient can be explained by the convergence of interests hypothesis. This result is consistent with some of the previous studies such as Earle (1998), Claessens and Dajankov (1999), Chen et al. (2003), and Kaserer and Moldenhauer (2008).

On the other hand, this study did not find any significant effect that depends on Tobin's Q. Our result is consistent with Agrawal and Knoeber (1996) and Faccio and Lasfer (1999), who found an insignificant relationship between managerial ownership and Tobin's Q. This result suggests that managerial ownership does not create or destroy firm value (Faccio and Lasfer, 1999). However, after controlling for endogeneity and applying dynamic GMM, the researcher found a positive effect with one lag and a negative effect with two lags of Tobin's Q, for which the dynamic GMM detected this unobservable heterogeneity. However, the coefficient of managerial ownership is very weak with Tobin's Q, which indicated that the relationship may be non-existent.

The interview results supported the regression results, which indicate that managerial ownership with large shares in the company leads to increased firm performance, because these managers take care of their shares and investments in the company. However, a number of participants suggested that managerial ownership has a negative effect upon firm performance and tends to destroy the firm's value, because managerial owners receive higher salaries and some advantages such as travel expenses, bonuses, and tuition fees for their children and do not care about the performance of the company just because they own 1000 shares (the requirement to become a board member).

9.5.2.2 Family or individual ownership

Jensen and Meckling (1976)'s agency theory argued that ownership concentration leads to reduced monitoring costs because large owners (family or individual) possess the incentive and expertise to monitor the managers (as cited in Miller & Breton-Miller, 2006). Most of the literature suggested that the relationship between family or individual ownership is positively related to firm performance. Exceptions (for example, Shyu, 2011) appear to relate to situations where the size of the family ownership interest is so large relative to non-family ownership that a situation referred to as "expropriation of the minority" (La Porta et al., 1999) may be occurring, in which the family looks after its own interests to such an extent that residual profits available for minority shareholders are limited.

Based on ROA, the current study found a highly negative significant relationship between family or individual ownership and ROA. This result indicated poor legal investor protection in some developing countries (Omran et al., 2008). Omran et al. (2008) found that family or individual ownership has a negative and significant impact on firm performance. This result indicates that family ownership interest appears to expropriate the minority, which means the family looks after its own interests to such an extent that residual profits available for minority shareholders are limited (La Porta et al., 1999; Shyu, 2011). Our results related to family or individual ownership based on the ROA still remain with the same sign (negative) after controlling for endogeneity and using a dynamic GMM that is controlled by one and two lags of ROA.

On the other hand, the current study found an insignificant relationship between family or individual ownership and Tobin's Q. However, in the dynamic GMM, the relationship between family or individual ownership and Tobin's is a significantly negative but weak coefficient. This situation illustrates the bias that may arise from ignoring the dynamic relationship between family or individual ownership, past ROA, and unobserved heterogeneity.

The interview results did not support the regression analysis with regards to family or individual ownership. The interview data showed that family or individual ownership has a strong and powerful role in increasing firm value and can affect firm performance in a positive way. These results are inconsistent with the quantitative results; this may be because the family or individual is not very well qualified and lacks the expertise to control and make important decision in the company and, therefore, may be making wrong decisions that decrease the firm's performance.

9.5.2.3 Government ownership

Government ownership looks at social and political policy goals rather than profit maximization (Sun et al., 2002). In Saudi Arabia, most of the government ownership is distributed in the utilities, servicing, and petrochemical sectors to enhance infrastructure and the welfare of the citizens. According to Sun et al. (2002), there is a conflict between the government's objectives and the firm's objectives: the government seeks to maximise welfare maximization, whereas firms seek to maximise profit. This conflict leads to agency problems and may be increase costs. Eng and Mak (2003) (as cited in Sulong and Nor, 2010) noted that agency costs are higher in firms that are primarily owned by the government, because they produce conflicts of interest between the pure profit goals of commercial firms and goals that are related to the national interest.

Regarding the regression analysis, this study found a highly positive significant relationship between government ownership and firm performance, even after controlling for endogeneity. Our results are supported by the findings of Sun et al. (2002) and Omran et al. (2008), who examined the relationship between government ownership and firm performance and found a positive relationship. In addition, the Saudi government supports and funds the Saudi stock market to achieve better performance by owning a substantial portion of the companies listed in Saudi capital market, and this argument explains the strong positive relationship between firm performance and government ownership. In addition, the existence of board members who represent any government agencies that own shares in the company provides the government with the incentive and power to monitor and control management as well as plays a significant role in corporate governance (Xu and Wang, 1999).

The interview results interpret and support the results from the quantitative data. Many of the participants argued that the existence of government ownership in a company indicates that this firm has a good long-term plan, good feasibility studies, and also a good corporate governance system. This kind of ownership attracts more investors and reassures minority shareholders, which in turn increases firm performance for the company for the capital market, because the government supports and funds the capital market to make it more active and develop it into a market that attracts foreign and local investors.

9.5.2.4 Foreign ownership

Foreign investors have more of the necessary sufficient experience and governance skills to reduce monitoring and agency cost problems in a corporation and provide corporations with sufficient resources (Dharwadkar et al., 2000; Djankov, 1999; Frydman et al., 1997). The results related to foreign ownership can be explained with two measures of firm performance. The first measure is ROA. The results dependent on ROA indicated that the relationship between ROA and foreign ownership was negative in the past (ROA is backward-looking). These results are acceptable, especially in the Saudi capital market, because the Saudi Arabian stock market does not seem ready to receive foreign investment, whereas Saudi companies seek infrastructural contributions from the government and, after that, seek to attract foreign investment. Perhaps foreign firms entered into competition with government agencies in a futile attempt to control some of the listed companies and lost, thus destroying the firm's performance.

The second measure is Tobin's Q (forward-looking). The results that depend on Tobin's Q reveal a highly positive significant relationship between foreign ownership and Tobin's Q. After controlling for endogeneity, the dynamic GMM still found a positive relationship; however, the coefficient on foreign ownership that related to Tobin's Q is very weak with one lag and there is no relationship at all with two lags. These results indicated that the companies listed in the Saudi capital market seek openness to the international markets and to attract foreign investment, which has a positive effect on market valuation in Saudi Arabia. The interview results mentioned that foreign ownership is very important to improve and develop the emerging market. However, they also believed that the foreign ownership did not have any significant effect, for the present, in Saudi Arabia.

9.5.2.5 Financial firms ownership

Financial firms play an important and pivotal role in business because they are the major source of external funds for firms (Ang et al., 2000). In addition, external shareholders (financial or bank ownership) have a higher degree of control and therefore have a good position to enforce a high level of productivity performance (Nickell et al., 1997). In Saudi Arabia, financial firms own most of the shares of the banking and insurance sectors listed in the capital market. This study excluded the banking and insurance sectors from the data, which should have an insignificant effect on firm performance.

This study revealed an insignificant relationship between financial firms ownership and firm performance based on both ROA and Tobin's Q. The reason for the insignificant relationship between financial firms ownership and ROA is that the majority of the financial firms own the shares in the banking and insurance corporations and our data contains all companies listed in the Saudi stock market, excluding the banking and insurance corporations. Moreover, financial firm ownership has a strong effect on banking and insurance corporations. However, in the dynamic GMM, the relationship between financial firms ownership and ROA is highly negatively significant. This situation illustrates the bias that may arise from ignoring the dynamic relationship between financial firms ownership, past ROA, and unobserved heterogeneity. This finding is along the same line as the finding of Morck et al. (2000) and Lin et al. (2009), who found that bank ownership hurt firm performance. Actually, our results support the argument of Lin et al. (2009), who argued that financial firms (bank) ownership destroys company performance due to inefficient borrowing and investment policies. In contrast, the dynamic GMM revealed the relationship between financial firms ownership and ROA to be highly positive significant, which indicates that financial firms ownership may be have a positive effect on the market value in the near future.

The interview results indicated that majority financial firm ownership produced mixed effects depending on the type of ownership. The majority of participants suggested that, when financial firms own large blocks of a company, they seek to enhance the firm performance by supporting the listed companies with low-interest funds. On the other hand, some participants did not invest their money in companies that are primarily owned by a bank or financial firm because the owner may destroy the firm if it cannot repay the loan given to it by the majority-owning bank.

9.5.2.6 Non-financial firms ownership

Gorton and Schmid (2000) argued that outside block shareholders played a vital role as monitors of management because the size of these external shareholders gave them more incentive to oversee management and reduce the free-rider problems experienced by small shareholders, which led to reduce the cost of monitoring. La Porta et al. (1998) argued that large blockholders in countries with weak legal protection for minority shareholders solved the agency problem and received a good return on investment. However, large blockholders may work toward their interests without paying any attention or concern to the minority shareholders.

Empirical studies on the relationship between non-financial firms ownership and firm performance have produced mixed results. Some of the literature, such as Holderness and Sheehan (1988), Mehran (1995), and Gorton and Schmid (2000), did not find any relationship for the period ending in 1974. However, some of the previous studies, such as Prowse (1992) and Morck et al. (2000), found a positive relationship. On the other hand, some scholars, such as Nickell et al. (1977), found a negative relationship between non-financial firms' ownership and firm performance.

The current study found a positive relationship between non-financial firms ownership and ROA before controlling for endogeneity. Actually, this result, as it pertains to non-financial firms ownership, did not reflect the actual results. However, after controlling for endogeneity in the dynamic GMM, the relationship between non-financial firms ownership and ROA is highly negative and significant. This dramatic sign flip illustrates the bias that may arise from ignoring the dynamic relationship between financial firms ownership, past ROA, and unobserved heterogeneity. Pham et al. (2011) used GMM and found a negative relationship between firm performance and non-financial firms ownership, but it was insignificant. Other literature, such as Lasfer (2002) and Davies et al. (2005), has found a negative relationship between large ownership and firm performance. Moreover, Mura (2007) used GMM as a methodology to permit simultaneous control for endogeneity of the independent variable and, as a result, found a negative relationship between non-financial ownership and firm performance. On the other hand, the results in regard to Tobin's Q were positive with all regression techniques, even after controlling for endogeneity.

The interview results supported the findings regarding non-financial firms ownership. A number of participants suggested that some of the large shareholders, such as corporations, have a negative impact on firm performance because they seek to maximize their interests, which negatively affects minority shareholders and decreases firm performance.

9.6 SUMMARY

This study seeks to provide an overview of corporate governance in the business environment in Saudi Arabia. To this end, the researcher employs both quantitative and qualitative approaches to elicit information from participants regarding the importance of corporate governance, the elements most in need of being developed, and the current corporate governance regulations or codes most in need of revision. The researcher also asks some questions related to the relationship between corporate governance and firm performance to support the results of the quantitative analysis. On the basis of the data analysis, this study proposes some results regarding the relationship between corporate governance mechanisms and firm performance in Saudi Arabia found mixed results. For example, board size found positive in the Saudi Arabia with concern on the quality rather than quantity. Non-executive members should have knowledge and experience to improve firm performance. Family board members have a positive effect on firm performance. Board of directors sub-committees members must be non-executive with good background to enhance firm performance. Royal family board members have a vital role that may be lead to increase firm value. The relationship between large ownership and firm performance is ambiguous that depends on the identity ownership.

10 CONCLUSION

10.1 INTRODUCTION

The main objective of this chapter is to summarise the main findings of this research. It highlights the contribution of this study through the findings from both methods that were used in this study. In addition, this chapter indentifies some limitations that faced the researcher during the PhD process, followed by a number of recommendations and suggestions for future research.

10.2 MAIN FINDINGS

The main findings of this research can be summarised in the following main points:

- ***How is corporate governance understood in the Saudi Arabian environment?***

1. The definition of Corporate governance reflects the interests and positions of the stakeholders. The participants divided into two main groups. The first group is focused on the internal process of corporate governance and is concerned with the responsibilities of the board of directors to manage the company using best practices to protect the shareholders' interests, based upon an agency perspective. The second group is adopted with more concern for all stakeholders related to the company. Both of these groups agree with Hussain and Mallin (2002), who stated that the definition of corporate governance implies that it provides a system of controls within the company, sets the relationship between the board of directors/shareholders/other stakeholders, and that the company is being managed according to the interests of both shareholders and stakeholders.
2. The existence of corporate governance regulations provides the shareholders with a greater level of comfort regarding their investments, attracts foreign investors, leads to enhancement of the macroeconomics of the country as well as enhancement of trustworthy capital markets, decreases investment risks and lowers levels of company corruption.

- ***What is the level of compliance with corporate governance provisions of Saudi Arabia among Saudi Arabian listed companies?***

  Listed companies in the Saudi capital market are legally obliged to disclose compliance with the corporate governance regulations that are issued by the Capital

Market Authority in Saudi Arabia. However, these regulations were issued at the end of 2006 as guidelines and the mandatory adherence of these regulations came in many steps. The researcher noted that from 2007 until the end of 2009 there was a number of listed companies with a low level of compliance with the regulations of corporate governance. From 2010, most of the listed companies were in compliance with all mandatory regulations. Honestly, there are a few listed companies which did not comply with some of the regulations, which led the Capital Market Authority to punish these companies, and to prevent them from registering in the capital market. From the statistical analysis, it is apparent that there are missing data in 2007, 2008, and 2009. Such data would reflect that there is a number of listed companies which did not comply with the corporate governance regulations that were issued from the Capital Market Authority.

- ***What are the main obstacles to corporate governance, as applied through the new regulations of the Saudi capital market?***

Lack of awareness, cost and time are the most frequently faced difficulties and obstacles that interfere with corporate governance practices in the companies.

- ***What are the main elements that corporate governance regulations need to improve and develop?***

1. The majority of interviewees demanded that the Saudi Capital Market Authority issue its manuals written in the simplest language, in order to make it easier for all stakeholders to understand the current regulations.
2. Most participants considered disclosure and transparency to be among the elements most in need of improvement and development.
3. To improve the current regulation of corporate governance, the Saudi Capital Market Authority should invite foreign members from international bodies, such as the OECD, UK and US agencies, to develop the current regulations in a way that achieves best practices.

- ***Is there any relationship between corporate governance mechanisms and firm performance? If so, what are its effects?***

1. This study found a significant positive relationship between board size and firm performance only with ROA, which is consistent with the interviewees results, which indicated that there is a positive relationship between board size and firm performance and a positive effect from concern for quality rather than quantity. Most of the emerging market participants found that the relationship between board size and performance is a positive one, which is consistent with this study, signifying that most emerging market participants require large board size with more resources, experience and skills.
2. There is no significant relationship between non-executive members and firm performance under the OLS model. Based on the 2SLS and GMM model after controlling for endogeneity, we found a significant relationship with firm performance. Most of the participants suggested that non-executive members should have knowledge and experience that helps to improve firm performance. On the other hand, some of the participants believed that some of the listed companies had appointed wealthy non-executives with good relationships with large shareholders, but who lack sufficient experience or knowledge to monitor the company, leading to bad performance.
3. This study found a positive relationship between family board members and firm performance based on ROA only. However, using the dynamic GMM model, which uses two lags of the Tobin's Q as a control factor, we found a highly negative significant relationship between family members. Most of the interviewees mentioned a positive relationship between having a family board member and the firm's performance. This positive relationship occurs when the family board member cares about the family's investments and reputation.
4. This study found a positive relationship between royal family board members and firm performance under the static model. However, the results after controlling for endogeneity, which depends on the GMM, indicated a negative relationship between royal family board members and firm performance. The sign flip is interesting and explains the bias that may arise from ignoring the unobservable heterogeneity and dynamics related to past performance. The interviewees mentioned that the royal family members who hold a significant number of shares have the power to increase the investment in the company by giving the company a good reputation, which leads to better performance in the future. On the other hand, another type of royal family member who acts as a non-executive without

owning a large number of shares may lead to bad performance because of a lack of experience and skill.

5. This study found an insignificant relationship between board sub-committees and firm performance under the static model. However, after controlling for endogeneity and applying the dynamic GMM, the board sub-committees took two paths. The results that depend on ROA (backward-looking) were significant and highly positive. In contrast, the Tobin’s Q (forward-looking) achieved highly significant negative results. The interview results mentioned that to gain high quality sub-committee performance, boards of directors should appoint just one or two members to each sub-committee to reduce conflict among members and facilitate good decision-making.
6. The relationship between managerial ownership and firm performance is positive with ROA only in the static model. Also, there were positive effects on both measures under the dynamic GMM. The interviewees suggested that managerial ownership with a large number of shares in the company leads to increased firm performance, because such managers take care of their shares and investments in the company.
7. The current study found a highly negative significant relationship between family or individual ownership and ROA. Our results related to family or individual ownership based on the ROA still remain with the same sign (negative) after controlling for endogeneity and using a dynamic GMM controlled by one and two lags of ROA. The results regarding Tobin's Q were found to be significantly negative with family or individual ownership under the GMM model. The interview data analysis reflected that family or individual ownership plays a powerful role in enhancing firm value and can positively affect firm performance. The results indicated that family ownership seems to have a negative effect on firm performance and just concerns itself with family interests while destroying minority interests.
8. This study found a highly positive significant relationship between government ownership and firm performance, even after controlling for endogeneity. Government ownership plays a vital role in the emerging markets. The existence of government ownership in a company indicates that the firm has a good long-term plan, good feasibility studies and a good corporate governance system.

9. The relationship between foreign ownership and firm performance is mixed in this study, depending on different measures and models. Based on ROA, the study found a negative relationship between foreign ownership and ROA. However, based on Tobin's Q it found a positive relationship with foreign ownership. The interview results indicated that foreign ownership is very important for improving and developing in emerging markets. However, the belief also exists that foreign ownership does not have any significant effect, for the present, in Saudi Arabia.
10. This study revealed an insignificant relationship between the ownership of financial firms and firm performance. However, in the dynamic GMM the relationship between the ownership of a financial firm and the firm’s performance is significant (negative with ROA, and positive with TQ). Some interviewees believe that a financial firm’s ownership can lead to destruction of the firm, because the owners might loan the company money at high interest rates and the company may not be able to repay such a loan, leading to destruction of the company.
11. The current study found a positive relationship between ownership by non-financial firms and firm performance before controlling for endogeneity. However, after controlling for endogeneity in the dynamic GMM, the relationship between ownership by non-financial firms and ROA is highly negative and significant. On the other hand, the results with regards to Tobin’s Q were positive under the GMM model. The interviewees suggested that ownership by a non-financial firm (corporation) has a negative impact on a firm’s performance because such an owner seeks to maximize its own interests, which negatively affects minority shareholders and decreases firm performance.

The table below summarises the relationship between corporate governance mechanisms and firm performance.

Table 10-1 Summary of the findings

Variables	Quantitative findings			Qualitative findings
	OLS	2SLS	GMM	
Board size	Significant positive relation to ROA only	Significant positive relation with ROA only	Significant positive relation with ROA only	The majority of interviewees supported the positive relationship between board size and firm performance, as well as concern for quality rather than quantity.
Non-executive members	None	Significant negative relation with ROA only	Significant negative relation with ROA, and significant positive relation with TQ, with two years of lag	Most of the participants suggested that non-executive members should have knowledge and experience that helps to improve firm performance.
Family board members	Significant positive relation to ROA only	Significant positive relation with ROA only	Significant positive relation with ROA only, and significant negative relation with TQ, with two years of lag	Family members would be more careful about family investments and have the desire to increase the firm's performance.
Royal family board members	Significant positive relation with ROA only	Significant positive relation	Significant negative relation	Royal family members who hold large shares play a vital role the company.
Board sub-committees	None	None	Significant positive relation with ROA, and significant negative relation with TQ	The interviewees mentioned that the majority of the sub-committee members must be non-executive and have backgrounds related to the function of the sub-committee, which means appointing specialized members in order for performance to be of high quality.
Managerial ownership	Significant positive relation with ROA only	Significant positive relation with ROA only	Significant positive relation with both measures, but negative significance with TQ, with two years of lag	Managerial ownership with large shares in the company leads to increased firm performance, because these managers protect their shares and investments in the company.
Family or individual ownership	Significant negative relation with ROA	None	Significant negative relation	Family or individual owners have a strong and powerful role in increasing firm value and can

	only			affect firm performance in a positive way; the interview results are inconsistent with the quantitative results.
Government ownership	Significant positive relation	Significant positive relation	Significant positive relation	The existence of government ownership in a company indicates that this firm has a good long-term plan, good feasibility studies, and also a good corporate governance system, all of which lead to better performance.
Foreign ownership	Significant negative relation with ROA, significant positive relation with TQ	Significant positive relation with TQ only	Significant negative relation with ROA, and significant positive relation with TQ with one lag and no relationship with two lags	Foreign ownership is a very important factor in terms of improving the emerging market. The data from the interviews demonstrated that foreign ownership did not have any significant effect, at present, in Saudi Arabia.
Financial ownership	None	None	Significant negative relation with ROA, and significant positive relation with TQ	When a financial firm owns large blocks of a company, it leads to enhancement of the firm's performance through support of the listed companies through low-interest funds. However, some of interviewees believe that the existence of ownership by a financial firm will lead to destruction of the company
Non-financial ownership	Significant positive relation	Significant positive relation	Significant negative relation with ROA, and significant positive relation with TQ	The large shareholders, such as corporations, have a negative impact on firm performance because they seek to maximize their interests.

10.3 CONTRIBUTION TO KNOWLEDGE

The main contribution of this study is that it considers the relationship between corporate governance mechanisms and firm performance in Saudi Arabia for the listed companies in the Saudi capital market for the period 2007 to 2011. This study fills the significant gap in the literature regarding corporate governance mechanisms in Saudi Arabia generally, and particularly the relationship between corporate governance and firm performance in Saudi Arabia. My hope is that this study provides a useful reference to study and examine the relationship between corporate governance mechanisms and firm performance in the MENA region, and also serves as a reference for the regulators, researchers, listed companies, and different stakeholders who have research interests in the corporate governance field in Saudi Arabia.

There is a limit number of studies concerned with the relationship between corporate governance and firm performance in the MENA region, e.g. (Al-Saidi, 2010; El Mehdi, 2007; Abu-Tapanjeh, 2006; Aljifri and Moustafa, 2007). However, each of those researchers took corporate governance and firm performance among different data (period and place). This means that the results from those studies may not be applicable to other countries, for example Saudi Arabia, because each country has specific features and corporate governance codes that are used to regulate the listed companies in the capital market. In addition, the ownership structures in Saudi Arabia differ from other countries; various families or individuals own shares in the listed companies in the Saudi capital market, and also the government owns significant shares in the some of the listed companies. These differences led the researcher to study the corporate governance and firm performance in listed companies in Saudi Arabia, and to fill the gap in the literature that concerns the study of the relationship between corporate governance and firm performance.

The corporate governance regulations in Saudi Arabia were issued at the end of 2006. It has been seven years since the establishment of these regulations until now. This study seeks to understand corporate governance within the Saudi Arabian business environment by applying semi-structured interviews with some of the corporate governance stakeholders. In addition, these interviews aim to evaluate the current practices of corporate governance and reveal how it can improve and develop. These semi-structured interviews can be used as guidelines that help decision makers and board of directors members to develop corporate governance mechanisms regarding some issues related to boards of directors and ownership structures in Saudi Arabian listed companies.

Most of the previous studies that concerned the relationship between corporate governance mechanisms and firm performance used statistical and econometric tests to examine this relationship. However, the current study used triangulation (mixed methods, quantitative, and qualitative). This researcher examined the relationship between corporate governance mechanisms and firm performances by using different econometric models. Moreover, the researcher conducted semi-structured interviews to explain in more detail the results of the quantitative analysis to examine the relationship between variables, and to help interpret the unexplained results from the quantitative data.

This study used two main methodological econometrics tests, static and dynamic, with three different approaches (OLS, 2SLS, and GMM). Most of the previous studies concerned the OLS approach and 2SLS (static model). A few studies used the dynamic GMM model to examine the relationship between corporate governance mechanisms and firm performance. This study provided three different types of regression models (OLS, 2SLS, and GMM) and compared the results between these models, while examining the endogeneity problem and unobserved heterogeneity that were detected by the dynamic GMM. Also, the researcher used the dynamic GMM to produce efficient and consistent estimations of the relationship between corporate governance mechanisms and firm performance as a developing area of research.

This current study attempted to build a full picture of the relationship between corporate governance and firm performance, by using various mechanisms of board of directors and ownership structures. Most of the previous studies concerned just some mechanisms or focused on just the board of directors or ownership structures separately. However, this study examined this relationship by using most of the ownership structures and board of directors structures, and put them together in one model to see how can these variables work together and affect firm performance. Furthermore, this study contributes to the literature by illustrating how corporate governance mechanisms can affect each other (endogeneity and causality).

Finally, this current study contributes to the literature by using a new variable, which is the presence of a royal family member on the board. The royal family board members act as a vital role to direct and manage listed companies in the Saudi capital market. This study used this variable as a dummy variable, which takes a value of 1 if the board of directors have a member from the royal family, and 0 otherwise. To my knowledge, this study is the first study to consider royal family board members as one of the board of directors structures, in order to build a new avenue for this area of research.

10.4 LIMITATIONS

The researcher faced a number of important limitations faced the researcher in this thesis. One of the chief difficulties was collecting data manually from the Tadawul and Capital Market Authority websites, and from board of directors' reports, and entering them into the Excel spreadsheet. This process took a long time; the researcher had data from five years, from a large number of companies, and each observation included fifteen variables. Unfortunately, there are no ready data for research purposes. The limitation is the reduction in the data's reliability due to the risk errors in entering data into the spreadsheet. Nevertheless, the researcher has tried to reduce this limitation by having the data checked by another person.

The second limitation was the difficulty of finding knowledgable members who had knowledge and information about corporate governance. Furthermore, when we did find a suitable member, communicating and arranging appointments with this member was very difficult, and it took a long time to find a suitable time and meet for a short time. This is because these types of members are very busy people, including board of directors members, large shareholders, auditors, regulators, and government agencies.

The third limitation was that some of the interviewees did not give me permission to record our conversations. Unfortunately, this problem appeared in most of the developing countries (Alghamdi, 2012). Surprisingly, one of interviewees asked me to stop the recording when I asked about his opinion on a specific topic. The danger is that the interview data may have reduced reliability, because some notes taken may be inaccurate and incomplete, without a recording of what was actually said.

The fourth limitation is that Saudi Arabia is a large country, and the companies are widely distributed. The researcher focused on the companies located in the eastern region, which includes industrial cities such as Jubail and Dammam. In addition, the researcher conducted interviews with some participants in Riyadh, which included the Capital Market Authority and government agencies. There are a number of companies located in the western region, and the researcher was not able to conduct interviews with the boards of directors in those companies because of the study's time frame (just three months) and the cost of travel to the western region. The limitation is the small sample size of the interview data, so when we have more time we may conduct interviews with more interviewees and participants from other cities and regions.

The fifth limitation, unfortunately, is that the findings of this research cannot be generalised to other countries from the Arabian Gulf or the Middle East and North Africa regions. The results of this study are limited to the listed companies in Saudi Arabia. Moreover, it is impossible to also generalise the results to non-listed companies or non-profit organizations. Each country or sectors have specific features and regulations that regulate and control them.

The sixth limitation is that there are a lot of missing data in the early years of studies because of a lack of disclosure regarding corporate governance variables. Also, some control variables that may have an effect on the relationship between corporate governance and firm performance are not involved in this study because the lack of disclosure of these data, such as data on R&D.

10.5 RECOMMENDATIONS

Based on the findings of this thesis, some recommendations can be concluded:

- ***General Recommendations***

1. All parts of the corporate governance regulation that were issued by the Capital Market Authority should be mandatory.
2. The Capital Market Authority should publish the regulations of corporate governance with more details in clear, easily understood language, to help the companies implement them correctly and achieve corporate governance goals.
3. Listed companies should be disclosed to the board of directors in English to enable the foreign investors to get more details about the company.
4. More effort should be make to consider disclosure and transparency. These two elements are very important and have a vital role in increasing investments in the

companies, attracting foreign investors, and improving the reputation of the Saudi capital market.

5. The Capital Market Authority is responsible for regulating and controlling the Saudi capital market. This authority has one department to take care of the corporate governance for listed companies. It is essential to establish a separate and independent agency with more responsibility to look after corporate governance for listed, non-listed, and non-profits firms.
6. Since foreign ownership is very important to improve and develop the Saudi capital market, the Capital Market Authority should facilitate the procedures for the entry of foreign investors to the Saudi capital market.
7. The corporate governance regulations need to be developed and improved regularly by revising the current codes to be able to cope with changes in economic conditions.
8. The Saudi Capital Market Authority should invite foreign members from international bodies, such as the OECD, UK, and US agencies, to develop the current regulations to reach the best practices.

- ***Research and Training***

1. There is a lack of central research in Saudi Arabia for overseeing corporate governance. These types of central research (by official bodies) have a vital role to improve and develop corporate governance mechanisms by providing the companies and stakeholders with a new research area in corporate governance and to assist them to prepare some training courses for directors and employees.
2. This study recommends increasing the awareness of corporate governance in Saudi Arabia through seminars that explain the positive side of corporate governance for developing the Saudi economy, and the Saudi market particularly. These efforts will ensure a decrease in investment risk and lower levels of company corruption.

- ***Specific Regulations***

1. The Saudi regulations of corporate governance provided that the board size should be not less than three and not more than eleven members. The board composition should be concerned with the quality of the board members with more knowledge, experience, and skills, rather than number of directors alone.

2. The majority of the subcommittee members must be non-executive and have backgrounds related to the function of the sub-committee, which means appointing specialized members who are capable of high-quality performance.
3. Put limitations on the bonus and travel expenses for the managerial staff, because when they receive higher salaries and some advantages, such as travel expenses, bonuses are unrelated to the performance of the company. Also, this study recommends increasing the number of shares required to become a board member, as 1000 shares are insignificant and perhaps do not provide the board members with enough incentive to pay attention to the company's performance.

- ***More Regulations (More details)***

1. There are no clear criteria to appoint non-executive members to the boards, so this research recommends that the Capital Market Authority issue regulations that explain the requirement for appointing non-executive members.
2. There are a number of families, individuals, and large blockholders (corporations) that own a significant number of shares in many listed companies in the Saudi capital market. This thesis recommends more legal protection for the minority shareholders' interests so they are protected from greed from the large shareholders.
3. This study recommends increased activation of the board sub-committees, by enhancing the role of the audit, nomination, and remuneration sub-committees. Furthermore, it recommends the issuance of some mandatory regulations to appoint members to those sub-committees, and to activate the role of the board secretaries by providing them with some skills and training to be able to do their jobs to the fullest extent.

10.6 SUGGESTIONS FOR FUTURE RESEARCH

There are several potential avenues for future research and improvement in the area of corporate governance. One possible avenue for future research is to examine the relationship between corporate governance mechanisms and firm performance using data from a cross-section of Arabian Gulf markets. Aside from Kuwait, all of the Arabian Gulf countries currently have specific codes of corporate governance. The researcher suggest that a cross-sectional study of one specific point or period be conducted and that the results of the cross-sectional study be compared. This procedure may enhance researchers' understanding of corporate governance mechanisms and their impact on firm performance throughout the countries of the Arabian Gulf.

The main aim of this study is to examine the relationship between corporate governance mechanisms and firm performance for the listed companies in the Saudi capital market. The relationship between corporate governance mechanisms and performance for non-listed companies in Saudi Arabia may also be worth investigating. In addition, the relationship between corporate governance and organisation performance in non-profit organizations in Saudi Arabia should be explored. The information gleaned from these studies will fill gaps in the current knowledge base and are likely to open up new avenues of research for corporate governance studies.

Future research can attempt to examine the relationship between corporate governance mechanisms and firm performance utilizing new means of measuring performance. Most previous studies focus on financial performance using ROA, ROE, and Tobin's Q. Based on this study, the researcher recommends using efficiency as a measure of firm performance and adopting the Data Envelopment Analysis (DEA) model as a tool with which to examine the relationship between corporate governance mechanisms and firm performance. Also, the researcher suggests using others measures of firm performance such as internal rate of return, cash flow return on investment, and discounted cash flow.

A number of listed companies have women on the board of directors. The role that female board members play in listed companies in Saudi Arabia is a new variable in the country. However, literature about female board members (board diversity) in the emerging market is limited, which suggest the relationship between female board members and firm performance as one potential area of future research.

Future research can also be conducted in the banking and insurance sectors (financial firms) with an emphasis on the relationship between corporate governance mechanisms and firm performance. Most of the literature excludes financial firms from the sample investigated. The results of this study suggest that the relationship between corporate governance mechanisms and firm performance be re-examined with the inclusion of financial firms in the sample.

This study focused on the internal corporate governance mechanisms (specifically, the structure of the board of directors and ownership structure) and their effect on firm performance. One important area of future research involves determining the role that external corporate governance mechanisms play, such as the takeover market and the legal and regulatory system, including audit, with regard to firm performance.

10.7 SUMMARY

This is the final chapter of this thesis. This thesis examined the relationship between corporate governance mechanisms and firm performance through listed companies in the Saudi capital market. This study used a combination of quantitative and qualitative methods to examine this relationship.

Using quantitative analysis, this study used three different models to examine this relationship: OLS, 2SLS, and GMM. This study also examined the endogeneity and detected unobserved heterogeneity by using dynamic GMM to get more consistent results. This study found that a number of corporate governance mechanisms have significant effects on firm performance, while some variables did not have any significant effect. When I applied dynamic GMM, I found some unobserved heterogeneity that impacted the relationship between this variable and firm performance.

Furthermore, based on the qualitative analysis, this study employed semi-structured interviews to support the results of the quantitative data, and also to cover some points that were not covered by the quantitative data and to explore in more detail the corporate governance mechanisms in Saudi Arabia. Most of the participants suggested that corporate governance definition must establish the relationship between board of directors, shareholders, and other stakeholders, and they recommended managing the company in the interests of both shareholders and stakeholders. Disclosure and transparency must be improved and developed according to the listed companies, including increasing the awareness of corporate governance in the Saudi Arabian business environment.

On the basis of the interview analysis, this study proposed main results regarding the relationship between corporate governance mechanisms and firm performance in Saudi Arabia:

1. Board size has a positive relationship with firm performacne in Saudi Arabia, with greater emphasis on the quality of the board members rather than the quantity.
2. Non-executive members should have knowledge and experience that help to improve firm performance.
3. The interviewees suggested that the relationship between the family board member and firm performance is positive, because a family member would be more careful about family investments and have a desire to increase the firm’s performance.
4. The interviewees suggested that the sub-committee members must be non-executive and have backgrounds related to the function of the sub-committee, which means appointing specialized members in order for performance to be of high quality.
5. The interviewees did not perceive that all royal family members play a vital role on the board of directors; some of the companies invite royal family board members to enhance their reputations and they did not have relevant knowledge and experience, which may lead to a decrease in firm performance.
6. The relationship between large owners and firm performance is ambiguous. Sometimes, large ownership is believed to have a positive impact on firm performance and other times a negative impact. This relationship depends on industry type, the portion of the large shareholders, and the type of large shareholder.

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Appendix 1: Interview questions

A- General questions about the concepts of corporate governance:

1- In your own words, what is the definition of corporate governance?
How would *you* define corporate governance?
What do you understand to be the meaning of the term "Corporate Governance"? *(board of directors and other stakeholders)*

2- How is corporate governance currently regulated in Saudi Arabia? *(directors and other stakeholders)*

3- Do you think the corporate governance code is important in principle for the companies listed in the Saudi Arabian capital market? Why do you think that? *(board of directors and other stakeholders)*

4- Do you think the corporate governance code is actually useful in practice in Saudi Arabia? Why? *(board of directors and other stakeholders)*

5- What is your overall evaluation of the corporate governance code in Saudi Arabia? *(board of directors and other stakeholders)*

6- Do you think that the current code of corporate governance in Saudi Arabia needs to be improved? What are the aspects that you think need to be improved the most and why? *(board of directors and other stakeholders)*

Turning to your own organisation:

7- Do the corporate governance practices in your own organisation have any effect [or impact] on your own organizational work? Think of both positive and negative effects. *(board of directors and other stakeholders)*

8- Are you aware of [Do you know of] any difficulties that interfere with the practices of corporate governance in your company? *(board of directors and other stakeholders)*

9- So based on your own experience, do you think that any provisions need to be added to (or, indeed, taken out of) the current Saudi corporate governance code? Please explain. *(board of directors and other stakeholders)*

B- Board of Directors:

1- In your own organisation, what are the responsibilities and roles of the board of directors? *(board of directors and other stakeholders)*

2- How is your board structured? Who is responsible for appointing board members? Do you look for any particular qualification, experience, knowledge or ability when appointing board members? *(board of directors)*

3- Do you think there should be any requirements (such as business experience, knowledge, good contacts, qualifications) for the board members? *(Other stakeholders).*
4- How many executive and non-executive directors does your company have? *(board of directors)*
5- What are the roles of the executive and non-executive directors? *(board of directors and other stakeholders)*
6- Do you think that the non-executive directors play a vital role in the company? Why do you think that? What are the requirements that influence the appointment of non-executive directors? *(board of directors and other stakeholders)*
7- Do you think that there is any relationship between firm performance and the percentage of non-executive directors? Please explain the reasons and give more information. *(board of directors and other stakeholders)*
8- Do you think that there is an optimal size for the board of directors? If so, what is it? What are the main factors that may influence the size of the board of directors? *(board of directors and other stakeholders)*
9- Do you think that there is any relationship between firm performance and the size of the board of directors? Please explain the reasons and give more information. *(board of directors and other stakeholders)*
10- Do you think that a family board member's serving on the board plays a vital role in the board of directors? How? *(board of directors and other stakeholders)*
11- Is there any relationship between the service of a family board member and firm performance? Explain this relationship. *(board of directors and other stakeholders)*
12- What do you think are the advantages and disadvantages of a separation between the roles of the CEO and the Chairman? Do you prefer the CEO to serve as the board Chairman or not? Why? *(board of directors and other stakeholders)*
13- What are the sub-committees of the board of directors at your company? Do you think that more sub-committees are needed or not? What is the effect of the sub-committees on financial performance? *(board of directors and other stakeholders)*

C- Ownership Structure:

1- What percentage of the shares should managers own? Do you think that there is an optimal size for the percentage of shares owned by managers? *(board of directors and other stakeholders)*

2- Do you think that large managerial shareholdings are good or bad for the minority shareholders? Please give reasons for your answer. *(board of directors and other stakeholders)*
3- Do you think that there is any relationship between managerial ownership and firm performance? How? *(board of directors and other stakeholders)*
    - Many companies in Saudi Arabia have large blocks of their shares owned by particular types of shareholder, such as the government, financial firms, non-financial firms, foreign investors, and families or individuals. Do you think that large blockholdings are good or bad for the minority shareholders? Do you think that this applies for *all* types of blockholders or would you make distinctions between different types of blockholder? *(board of directors and other stakeholders)*
4- Do you think that there is any relationship between large blockholders' ownership described above and firm performance? How? *(board of directors and other stakeholders)*
5- Do you think that ownership concentration creates problems in the Saudi capital market or not? Why? *(board of directors and other stakeholders)*

Is there anything about corporate governance that we haven't covered but that you want to tell me?

Appendix 2 : Corporate governance regulations in Saudi Arabai

CAPITAL MARKET AUTHORITY

CORPORATE GOVERNANCE REGULATIONS
IN THE KINGDOM OF SAUDI ARABIA

Issued by the Board of Capital Market Authority
Pursuant to Resolution No. 1/212/2006
dated 21/10/1427AH (corresponding to 12/11/2006)
based on the Capital Market Law
issued by Royal Decree No. M/30
dated 2/6/1424AH

Amended by Resolution of the Board of the Capital Market Authority Number 1-10-2010 Dated 30/3/1431H corresponding to 16/3/2010G

English Translation of the Official Arabic Text

Arabic is the official language of the Capital Market Authority

The current version of these Rules, as may be amended, can be found aton the CMA website: www.cma.org.sa

CONTENTS

PART 1
PRELIMINARY PROVISIONS

Article 1: Preamble

a) These Regulations include the rules and standards that regulate the management of joint stock companies listed in the Exchange to ensure their compliance with the best governance practices that would ensure the protection of shareholders' rights as well as the rights of stakeholders.

b) These Regulations constitute the guiding principles for all companies listed in the Exchange unless any other regulations, rules or resolutions of the Board of the Authority provide for the binding effect of some of the provisions herein contained.

c) As an exception of paragraph (b) of this article, a company must disclose in the Board of Directors` report, the provisions that have been implemented and the provisions that have not been implemented as well as the reasons for not implementing them.

Article 2: Definitions

a) Expression and terms in these regulations have the meanings they bear in the Capital Market Law and in the glossary of defined terms used in the regulations and the rules of the Capital Market Authority unless otherwise stated in these regulations.

b) For the purpose of implementing these regulations, the following expressions and terms shall have the meaning they bear as follows unless the contrary intention appears:

Independent Member: A member of the Board of Directors who enjoys complete independence. By way of example, the following shall constitute an infringement of such independence:

1. he/she holds a five per cent or more of the issued shares of the company or any of its group.
2. Being a representative of a legal person that holds a five per cent or more of the issued shares of the company or any of its group.

3. he/she, during the preceding two years, has been a senior executive of the company or of any other company within that company's group.
4. he/she is a first-degree relative of any board member of the company or of any other company within that company's group.

5. he/she is first-degree relative of any of senior executives of the company or of any other company within that company's group.

6. he/she is a board member of any company within the group of the company which he is nominated to be a member of its board.

7. If he/she, during the preceding two years, has been an employee with an affiliate of the company or an affiliate of any company of its group, such as external auditors or main suppliers; or if he/she, during the preceding two years, had a controlling interest in any such party.

Non-executive director: A member of the Board of Directors who does not have a full-time management position at the company, or who does not receive monthly or yearly salary.

First-degree relatives: father, mother, spouse and children.

Stakeholders: Any person who has an interest in the company, such as shareholders, employees, creditors, customers, suppliers, community.

Accumulative Voting: a method of voting for electing directors, which gives each shareholder a voting rights equivalent to the number of shares he/she holds. He/she has the right to use them all for one nominee or to divide them between his/her selected nominees without any duplication of these votes. This method increases the chances of the minority shareholders to appoint their representatives in the board through the right to accumulate votes for one nominee.

Minority Shareholders: Those shareholders who represent a class of shareholders that does not control the company and hence they are unable to influence the company.

PART 2
RIGHTS OF SHAREHOLDERS AND THE GENERAL ASSEMBLY

Article 3: General Rights of Shareholders

A Shareholder shall be entitled to all rights attached to the share, in particular, the right to a share of the distributable profits, the right to a share of the company's assets upon liquidation; the right to attend the General Assembly and participate in deliberations and vote on relevant decisions; the right of disposition with respect to shares; the right to supervise the Board of Directors activities, and file responsibility claims against board members; the right to inquire and have access to information without prejudice to the company's interests and in a manner that does not contradict the Capital Market Law and the Implementing Rules.

Article 4: Facilitation of Shareholders Exercise of Rights and Access to Information

a) The company in its Articles of Association and by-laws shall specify the procedures and precautions that are necessary for the shareholders' exercise of all their lawful rights.

b) All information which enable shareholders to properly exercise their rights shall be made available and such information shall be comprehensive and accurate; it must be provided and updated regularly and within the prescribed times; the company shall use the most effective means in communicating with shareholders. No discrepancy shall be exercised with respect to shareholders in relation to providing information.

Article 5[1]: Shareholders Rights related to the General Assembly

a) A General Assembly shall convene once a year at least within the six months following the end of the company's financial year.

b) The General Assembly shall convene upon a request of the Board of Directors. The Board of Directors shall invite a General Assembly to convene pursuant to a request of the auditor or a number of shareholders whose shareholdings represent at least 5% of the equity share capital.

[1] The Board of the Capital Market Authority issued resolution Number (3-40-2012) Dated 17/2/1434H corresponding to 30/12/2012G making paragraphs (i) and (j) of Article 5 of the Corporate Governance Regulations mandatory on all companies listed on the Exchange effective from 1/1/2013G.

c) Date, place, and agenda of the General Assembly shall be specified and announced by a notice, at least 20 days prior to the date the meeting; invitation for the meeting shall be published in the Exchange' website, the company's website and in two newspapers of voluminous distribution in the Kingdom. Modern high tech means shall be used in communicating with shareholders.

d) Shareholders shall be allowed the opportunity to effectively participate and vote in the General Assembly; they shall be informed about the rules governing the meetings and the voting procedure.

e) Arrangements shall be made for facilitating the participation of the greatest number of shareholders in the General Assembly, including *inter alia* determination of the appropriate place and time.

f) In preparing the General Assembly's agenda, the Board of Directors shall take into consideration matters shareholders require to be listed in that agenda; shareholders holding not less than 5% of the company's shares are entitled to add one or more items to the agenda. upon its preparation.

g) Shareholders shall be entitled to discuss matters listed in the agenda of the General Assembly and raise relevant questions to the board members and to the external auditor. The Board of Directors or the external auditor shall answer the questions raised by shareholders in a manner that does not prejudice the company's interest.

h) Matters presented to the General Assembly shall be accompanied by sufficient information to enable shareholders to make decisions.

i) Shareholders shall be enabled to peruse the minutes of the General Assembly; the company shall provide the Authority with a copy of those minutes within 10 days of the convening date of any such meeting.

j) The Exchange shall be immediately informed of the results of the General Assembly.

Article 6: Voting Rights

a) Voting is deemed to be a fundamental right of a shareholder, which shall not, in any way, be denied. The company must avoid taking any action which might hamper the use of the voting right; a shareholder must be afforded all possible assistance as may facilitate the exercise of such right.

b) In voting in the General Assembly for the nomination to the board members, the accumulative voting method shall be applied.

c) A shareholder may, in writing, appoint any other shareholder who is not a board member and who is not an employee of the company to attend the General Assembly on his behalf.

d) Investors who are judicial persons and who act on behalf of others - e.g. investment funds- shall disclose in their annual reports their voting policies, actual voting, and ways of dealing with any material conflict of interests that may affect the practice of the fundamental rights in relation to their investments.

Article 7: Dividends Rights of Shareholders

a) The Board of Directors shall lay down a clear policy regarding dividends, in a manner that may realize the interests of shareholders and those of the company; shareholders shall be informed of that policy during the General Assembly and reference thereto shall be made in the report of the Board of Directors.

b) The General Assembly shall approve the dividends and the date of distribution. These dividends, whether they be in cash or bonus shares shall be given, as of right, to the shareholders who are listed in the records kept at the Securities Depository Center as they appear at the end of trading session on the day on which the General Assembly is convened.

PART 3

DISCLOSURE AND TRANSPARENCY

Article 8:Policies and Procedure related to Disclosure

The company shall lay down in writing the policies, procedures and supervisory rules related to disclosure, pursuant to law.

Article 9 [2]: Disclosure in the Board of Directors' Report

In addition to what is required in the Listing Rules in connection with the content of the report of the Board of Directors, which is appended to the annual financial statements of the company, such report shall include the following:

a) The implemented provisions of these Regulations as well as the provisions which have not been implemented, and the justifications for not implementing them.

b) Names of any joint stock company or companies in which the company Board of Directors member acts as a member of its Board of directors.

c) Formation of the Board of Directors and classification of its members as follows: executive board member, non-executive board member, or independent board member.

d) A brief description of the jurisdictions and duties of the Board's main committees such as the Audit Committee, the Nomination and Remuneration Committee; indicating their names, names of their chairmen, names of their members, and the aggregate of their respective meetings.

[2] The Board of the Capital Market Authority issued resolution Number (1-36-2008) Dated 12/11/1429H corresponding to 10/11/2008G making Article 9 of the Corporate Governance Regulations mandatory on all companies listed on the Exchange effective from the first board report issued by the company following the date

of the Board of the Capital Market Authority resolution mentioned above.

e) Details of compensation and remuneration paid to each of the following:
    1. The Chairman and members of the Board of Directors.
    2. The Top Five executives who have received the highest compensation and remuneration from the company. The CEO and the chief finance officer shall be included if they are not within the top five.

       For the purpose of this paragraph, "compensation and remuneration" means salaries, allowances, profits and any of the same; annual and periodic bonuses related to performance; long or short- term incentive schemes; and any other rights *in rem*.

f) Any punishment or penalty or preventive restriction imposed on the company by the Authority or any other supervisory or regulatory or judiciary body.
g) Results of the annual audit of the effectiveness of the internal control procedures of the company.

PART 4

BOARD OF DIRECTORS

Article 10[3]: Main Functions of the Board of Directors

Among the main functions of the Board is the fallowing:

a) Approving the strategic plans and main objectives of the company and supervising their implementation; this includes:

  1. Laying down a comprehensive strategy for the company, the main work plans and the policy related to risk management, reviewing and updating of such policy.

  2. Determining the most appropriate capital structure of the company, its strategies and financial objectives and approving its annual budgets.

  3. Supervising the main capital expenses of the company and acquisition/disposal of assets.

  4. Deciding the performance objectives to be achieved and supervising the implementation thereof and the overall performance of the company.

  5. Reviewing and approving the organizational and functional structures of the company on a periodical basis.

b) Lay down rules for internal control systems and supervising them; this includes:

  1. Developing a written policy that would regulates conflict of interest and remedy any possible cases of conflict by members of the Board of Directors, executive management and shareholders. This includes misuse of the company's assets

[3] The Board of the Capital Market Authority issued resolution Number (1-33-2011) Dated 3/12/1432H corresponding to 30/10/2011G making paragraph (b) of Article 10 of the Corporate Governance Regulations mandatory on all companies listed on the Exchange effective from 1/1/2012.
- The Board of the Capital Market Authority issued resolution Number (3-40-2012) Dated 17/2/1434H

corresponding to 30/12/2012G making paragraphs (c) and (d) of Article 10 of the Corporate Governance Regulations mandatory on all companies listed on the Exchange effective from 30/6/2013G.

and facilities and the arbitrary disposition resulting from dealings with the related parties.

2. Ensuring the integrity of the financial and accounting procedures including procedures related to the preparation of the financial reports.

3. Ensuring the implementation of control procedures appropriate for risk management by forecasting the risks that the company could encounter and disclosing them with transparency.

4. Reviewing annually the effectiveness of the internal control systems.

c) Drafting a Corporate Governance Code for the company that does not contradict the provisions of this regulation, supervising and monitoring in general the effectiveness of the code and amending it whenever necessary.

d) Laying down specific and explicit policies, standards and procedures, for the membership of the Board of Directors and implementing them after they have been approved by the General Assembly.

e) Outlining a written policy that regulate the relationship with stakeholders with a view to protecting their respective rights; in particular, such policy must cover the following:

1. Mechanisms for indemnifying the stakeholders in case of contravening their rights under the law and their respective contracts.

2. Mechanisms for settlement of complaints or disputes that might arise between the company and the stakeholders.

3. Suitable mechanisms for maintaining good relationships with customers and suppliers and protecting the confidentiality of information related to them.

4. A code of conduct for the company's executives and employees compatible with the proper professional and ethical standards, and regulate their relationship with the stakeholders. The Board of Directors lays down procedures for supervising this code and

ensuring compliance there with.

5. The Company's social contributions.

f) Deciding policies and procedures to ensure the company's compliance with the laws and regulations and the company's obligation to disclose material information to shareholders, creditors and other stakeholders.

Article 11 : Responsibilities of the Board

a) Without prejudice to the competences of the General Assembly, the company's Board of Directors shall assume all the necessary powers for the company's management. The ultimate responsibility for the company rests with the Board even if it sets up committees or delegates some of its powers to a third party. The Board of Directors shall avoid issuing general or indefinite power of attorney.

b) The responsibilities of the Board of Directors must be clearly stated in the company's Articles of Association.

c) The Board of Directors must carry out its duties in a responsible manner, in good faith and with due diligence. Its decisions should be based on sufficient information from the executive management, or from any other reliable source.

d) A member of the Board of Directors represents all shareholders; he undertakes to carry out whatever may be in the general interest of the company, but not the interests of the group he represents or that which voted in favor of his appointment to the Board of Directors.

e) The Board of Directors shall determine the powers to be delegated to the executive management and the procedures for taking any action and the validity of such delegation. It shall also determine matters reserved for decision by the Board of Directors. The executive management shall submit to the Board of Directors periodic reports on the exercise of the delegated powers.

f) The Board of Directors shall ensure that a procedure is laid down for orienting the new board members of the company's business and, in particular, the financial and legal aspects, in addition to their training, where necessary.

g) The Board of Directors shall ensure that sufficient information about the company is made available to all members of the Board of Directors, generally, and, in particular, to the non-executive members, to enable them to discharge their duties and responsibilities in an effective manner.

h) The Board of Directors shall not be entitled to enter into loans which spans more than three years, and shall not sell or mortgage real estate of the company, or drop the company's debts, unless it is authorized to do so by the company's Articles of Association. In the case where the company's Articles of Association includes no provisions to this respect, the Board should not act without the approval of the General Assembly, unless such acts fall within the normal scope of the company's business.

Article 12 [4]: Formation of the Board

Formation of the Board of Directors shall be subject to the following:

a) The Articles of Association of the company shall specify the number of the Board of Directors members, provided that such number shall not be less than three and not more than eleven.

b) The General Assembly shall appoint the members of the Board of Directors for the duration provided for in the Articles of Association of the company, provided that such duration shall not exceed three years. Unless otherwise provided for in the Articles of Association of the company, members of the Board may be reappointed.

c) The majority of the members of the Board of Directors shall be non-executive members.

d) It is prohibited to conjoin the position of the Chairman of the Board of Directors with any other executive position in the company, such as

[4] The Board of the Capital Market Authority issued resolution Number (1-36-2008) Dated 12/11/1429H corresponding to 10/11/2008G making paragraphs (c) and (e) of Article 12 of the Corporate Governance Regulations mandatory on all companies listed on the Exchange effective from year 2009.
- The Board of the Capital Market Authority issued resolution Number (3-40-2012) Dated 17/2/1434H

corresponding to 30/12/2012G making paragraph (g) of Article 12 of the Corporate Governance Regulations mandatory on all companies listed on the Exchange effective from 1/1/2013G.

the Chief Executive Officer (CEO) or the managing director or the general manager.

e) The independent members of the Board of Directors shall not be less than two members, or one-third of the members, whichever is greater.

f) The Articles of Association of the company shall specify the manner in which membership of the Board of Directors terminates. At all times, the General Assembly may dismiss all or any of the members of the Board of Directors even though the Articles of Association provide otherwise.

g) On termination of membership of a board member in any of the ways of termination, the company shall promptly notify the Authority and the Exchange and shall specify the reasons for such termination.

h) A member of the Board of Directors shall not act as a member of the Board of Directors of more than five joint stock companies at the same time.

i) Judicial person who is entitled under the company's Articles of Association to appoint representatives in the Board of Directors, is not entitled to nomination vote of other members of the Board of Directors.

Article 13: Committees of the Board

a) A suitable number of committees shall be set up in accordance with the company's requirements and circumstances, in order to enable the Board of Directors to perform its duties in an effective manner.

b) The formation of committees subordinate to the Board of Directors shall be according to general procedures laid down by the Board, indicating the duties, the duration and the powers of each committee, and the manner in which the Board monitors its activities. The committee shall notify the Board of its activities, findings or decisions with complete transparency. The Board shall periodically pursue the activities of such committees so as to ensure that the activities entrusted to those committees are duly performed. The Board shall approve the by-laws of all committees of the Board, including, *inter* *alia*, the Audit Committee, Nomination and Remuneration Committee.

c) A sufficient number of the non-executive members of the Board of Directors shall be appointed in committees that are concerned with activities that might involve a conflict of interest, such as ensuring the integrity of the financial and non-financial reports, reviewing the deals concluded by related parties, nomination to membership of the Board, appointment of executive directors, and determination of remuneration.

Article 14 [5]: Audit Committee

a) The Board of Directors shall set up a committee to be named the "Audit Committee". Its members shall not be less than three, including a specialist in financial and accounting matters. Executive board members are not eligible for Audit Committee membership.

b) The General Assembly of shareholders shall, upon a recommendation of the Board of Directors, issue rules for appointing the members of the Audit Committee and define the term of their office and the procedure to be followed by the Committee.

c) The duties and responsibilities of the Audit Committee include the following:

1. To supervise the company's internal audit department to ensure its effectiveness in executing the activities and duties specified by the Board of Directors.
2. To review the internal audit procedure and prepare a written report on such audit and its recommendations with respect to it.
3. To review the internal audit reports and pursue the implementation of the corrective measures in respect of the comments included in them.
4. To recommend to the Board of Directors the appointment, dismissal and the Remuneration of external auditors; upon any

[5] The Board of the Capital Market Authority issued resolution Number (1-36-2008) Dated 12/11/1429H corresponding to 10/11/2008G making Article 14 of the Corporate Governance Regulations mandatory on all companies listed on the Exchange effective from year 2009.

such recommendation, regard must be made to their independence.

5. To supervise the activities of the external auditors and approve any activity beyond the scope of the audit work assigned to them during the performance of their duties.

6. To review together with the external auditor the audit plan and make any comments thereon.

7. To review the external auditor's comments on the financial statements and follow up the actions taken about them.

8. To review the interim and annual financial statements prior to presentation to the Board of Directors; and to give opinion and recommendations with respect thereto.

9. To review the accounting policies in force and advise the Board of Directors of any recommendation regarding them.

Article 15[6]: Nomination and Remuneration Committee

a) The Board of Directors shall set up a committee to be named "Nomination and Remuneration Committee".

b) The General Assembly shall, upon a recommendation of the Board of Directors, issue rules for the appointment of the members of the Nomination and Remuneration Committee, terms of office and the procedure to be followed by such committee.

c) The duties and responsibilities of the Nomination and Remuneration Committee include the following:

   1. Recommend to the Board of Directors appointments to membership of the Board in accordance with the approved policies and standards; the Committee shall ensure that no person who has been previously convicted of any offense affecting honor or honesty is nominated for such membership.

[6] The Board of the Capital Market Authority issued resolution Number (1-10-2010) Dated 30/3/1431H corresponding to 16/3/2010G making Article 15 of the Corporate Governance Regulations mandatory on all companies listed on the Exchange effective from 1/1/2011G.

2. Annual review of the requirement of suitable skills for membership of the Board of Directors and the preparation of a description of the required capabilities and qualifications for such membership, including, *inter alia*, the time that a Board member should reserve for the activities of the Board.

3. Review the structure of the Board of Directors and recommend changes.

4. Determine the points of strength and weakness in the Board of Directors and recommend remedies that are compatible with the company's interest.

5. Ensure on an annual basis the independence of the independent members and the absence of any conflict of interest in case a Board member also acts as a member of the Board of Directors of another company.

6. Draw clear policies regarding the indemnities and remunerations of the Board members and top executives; in laying down such policies, the standards related to performance shall be followed.

Article 16: Meetings of the Board

1. The Board members shall allot ample time for performing their responsibilities, including the preparation for the meetings of the Board and the permanent and ad hoc committees, and shall endeavor to attend such meetings.

2. The Board shall convene its ordinary meetings regularly upon a request by the Chairman. The Chairman shall call the Board for an unforeseen meeting upon a written request by two of its members.

3. When preparing a specified agenda to be presented to the Board, the Chairman should consult the other members of the Board and the CEO. The agenda and other documentation should be sent to the members in a sufficient time prior to the meeting so that they may be able to consider such matters and prepare themselves for the meeting. Once convened, the Board shall approve the agenda; should any member of the Board raise any objection to this agenda, the details of such

objection shall be entered in the minutes of the meeting.

4. The Board shall document its meetings and prepare records of the deliberations and the voting, and arrange for these records to be kept in chapters for ease of reference.

Article 17: Remuneration and Indemnification of Board Members

The Articles of Association of the company shall set forth the manner of remunerating the Board members; such remuneration may take the form of a lump sum amount, attendance allowance, rights *in rem* or a certain percentage of the profits. Any two or more of these privileges may be conjoined.

Article 18. Conflict of Interest within the Board

a) A Board member shall not, without a prior authorization from the General Assembly, to be renewed each year, have any interest (whether directly or indirectly) in the company's business and contracts. The activities to be performed through general bidding shall constitute an exception where a Board member is the best bidder. A Board member shall notify the Board of Directors of any personal interest he/she may have in the business and contracts that are completed for the company's account. Such notification shall be entered in the minutes of the meeting. A Board member who is an interested party shall not be entitled to vote on the resolution to be adopted in this regard neither in the General Assembly nor in the Board of Directors. The Chairman of the Board of Directors shall notify the General Assembly, when convened, of the activities and contracts in respect of which a Board member may have a personal interest and shall attach to such notification a special report prepared by the company's auditor.

b) A Board member shall not, without a prior authorization of the General Assembly, to be renewed annually, participate in any activity which may likely compete with the activities of the company, or trade in any branch of the activities carried out by the company.

c) The company shall not grant cash loan whatsoever to any of its Board members or render guarantee in respect of any loan entered into by a

Board member with third parties, excluding banks and other fiduciary companies.

PART 5
CLOSING PROVISIONS

Article 19: Publication and Entry into Force

These regulations shall be effective upon the date of their publication.