CORPORATE GOVERNANCE AND FOREIGN PORTFOLIO INVESTMENT IN SAUDI ARABIA

MOHAMMED GUBRAN MOHAMMED AHMED

UNIVERSITI UTARA MALAYSIA
2012

CORPORATE GOVERNANCE AND FOREIGN PORTFOLIO INVESTMENT IN SAUDI ARABIA

By

MOHAMMED GUBRAN MOHAMMED AHMED

(803925)

A Thesis Submitted to Othman Yeop Abdullah Graduate School of Accounting in Partial Fulfillment of the Requirement for the Degree Master Science of International Accounting
Universiti Utara Malaysia

PERMISSION TO USE

In presenting this thesis in partial fulfillment of the requirements for the postgraduate degree of Master of Science (International Accounting) from the Universiti Utara Malaysia, I agree that the University's library may take it freely available for inspection. I further agree that the permission for copying of this thesis in any manner, in whole or in part, for scholarly purpose may be granted by my supervisor or, in his absence, by the Dean of the College of Business. It is understood that any copy or publication or use of this thesis or parts thereof for financial gain shall not be allowed without my written permission. It is also understood that due recognition shall be given to me and to the Universiti Utara Malaysia for any scholarly use which may be made of any material from my thesis.

Request for permission to copy or make other use of material in this thesis in whole or in part should be addressed to:

Dean of Othman Yeop Abdullah Graduate School of Accounting
Universiti Utara Malaysia
06010 UUM Sintok
Kedah Darul Aman

ABSTRACT

A corporate governance system has been designed to ensure efficient operations of companies on behalf of shareholders. Good practices of corporate governance principles and high protection of investors would attract foreign portfolio investment. This study aims to investigate the effect of corporate governance mechanisms (i.e. board size, board independence, audit committee size, audit committee independence and firm age) on foreign portfolio investment in Saudi listed firms for the year 2010. This study is significant due to the lack of empirical evidence regarding the field of corporate governance and foreign portfolio investment in Saudi firms since the Saudi code of corporate governance has been enacted in the late 2006. The results of the study show that board independence and audit committee independence are associated with foreign portfolio investment in Saudi listed firms. However, the corporate governance mechanisms, i.e. board size, audit committee size and firm age had no impact on foreign portfolio investment.

ACKNOWLEDGEMENT

In the name of Allah the most gracious, the merciful, I praise to Allah and thank to him for the blessing of complete this study. My special thanks of reaching this stage to the following. First for most, I feel proud to express my deepest gratitude, profound and deepest sense of appreciation to my supervisor Prof. Ku Nor Izah Ku Ismail for her thoughtful guidance, sagacious advices, valuable suggestions, precious comments during discussions, and her continuous encouragement to make my research successful.

Without forgetting, my warmest special gratitude to my father and my beloved mother, who always pray to Allah for helping me. My sincere appreciation also goes to my brothers, specially my big brother Ali AL-Shamahi, and sisters for their encouragement. My highest regards and deepest appreciation go to my dearest wife and my dearest kids Gubran, Khulood and Jna for their encouragement, moral support, patience and understanding.

Finally, if this modest effort is successful, it is by Allah's grace and guidance and if it falls short of the readers' expectations, we can only pray and hope that Allah will forgive me.

Mohammed Gubran Mohammed Ahmed AL-Shamahi

Table of Contents

List of Table

List of Figures

CHAPTER ONE

INTRODUCTION

1.1 Background of the Study

Corporate governance has been a common issue in recent years. It started in 1992 in the UK with the Cadbury Committee Report. This Report, on corporate governance, was the output of many high profile companies that were concerned, mainly, with weak protection of shareholders against the self-interests of managers and directors. In response to the corporate scandals, the US Congress approved the Sarbanes - Oxley Act on July, 2002; this Act aimed to enhance the practice of corporate governance and make it more transparent to shareholders and any users of financial reporting. In addition to this, and according to Organization for Economic Development (Kimberly, 2002), foreign portfolio investments might also assist the home capital market by way of the creation of advanced implementations and methods to observe the portfolios. For example, financial reporting users and shareholders can utilize futures, options, swaps, hedging instruments, etc., to manage portfolio risk. This can be conducive to domestic markets, by improving risk management opportunities for all investors. Foreign portfolio investment can help strengthen and improve the functioning of domestic capital markets, hence bringing about better capital allocation and a healthier economy. Open markets also avail opportunities to foreign investors to diversify their portfolios, improve risk management and foster higher level of savings and investment. This leads to a better allocation of wealth and funds in the local economy, and thus improved the health of the economy. Open capital markets are also conducive for economic development and there is increasing prevalence around the world, of saving of resources. Opening markets to foreign investors provides the opportunity to diversify their portfolios, improve risk management and allow an improved degree of savings and investment.

Foreign investment can be called an acquisition of assets by governments or institutions or individuals in one country in another country. Foreign investment includes both direct investment and portfolio investment, in public authorities, private companies and individuals. For a country where there is cash savings, a sufficient proportion of demand is likely to be invested, in which, foreign capital can be a fruitful way to stimulate the rapid growth of the economy of the host country (Borensztein, De Gregorio & Lee , 1998). As has been shown above foreign portfolio investment can be an important player in this function, and bring additional strengths and benefits, but those benefits will be most effective when working within a healthy financial system.

Earlier this year 2006, the Saudi Arabian Capital Market Authority (CMA) mandated increased compliance with the regulations of corporate governance (Corporate Governance Regulations) dated 12th November 2006. The Corporate Governance Regulations primarily covers joint-stock companies that are listed in the Saudi Arabian Capital Market (Tadawul). These rules were not mandatory at the time of their establishment and it generally adopted the comply-or-explain policy. The rules have changed as of January 2009, as companies that are listed on Tadawul have no choice but to comply, as mandated by the CMA, in order to enhance transparency and to protect the rights of the shareholders. The rules that are made mandatory require the director's annual report to contain information regarding: i) compliance code with the Corporate Governance Regulations, ii) the composition of the board of directors to be balanced between executive and non-executive directors, along with independent directors and other joint-stock company directors who have seats on the board of directors, iii) a summary description of the committees composition created by the board of directors like audit committees, nomination and remuneration committees etc., iv) complete details of the compensation and remuneration of the chairman of the board, and the top five highest paid executives, including the CEO and the CFO, even if they are not among the five, v) any form of punishment, penalty or limitations imposed by a regulatory, executive or judicial authority upon the company and vi) the annual review of the firm's internal audit's effectiveness.

Besides this, the mandatory rules require the board members to comprise a majority of non-executives, while the independent members must be at least two members or one third of the board members, whichever is the greater. Additionally, an audit committee must comprise not less than three non-executive directors and one of them must have a financial background. This committee will be responsible to establish a robust internal control, to deal with external auditors and to devise suitable accounting policies, among other responsibilities (King & Spalding, 2011).

The Capital Market Authority (CMA) has also carried out other amendments along with the mandatory rules of the Corporate Governance Regulations in 2009 and 2010, in its attempt to boost transparency in the Saudi capital market. These amendments were carried out in an attempt to clarify the definition and selection criteria of an ‘independent member’ and disclosures that are needed regarding conflict of interest and the board members’ remuneration. With effect from January, 2011, it is mandatory for companies listed in Tadawul to comply with Article 15 of the Corporate Governance Regulations and form a nomination and remuneration committee by the Board of Directors. The nomination and remuneration committee’s primary role includes: to advice, review and audit the rules and policies regarding the appointment, qualifications, structure, authority, independency and remunerations of the board members, among others. The rules regarding the composition of such a committee will be laid down by the Board of Directors with the approval of the shareholders in a general assembly.

The Capital Market Authority (CMA) licensed companies conducting capital market activities are also under the purview of the corporate governance rules, according to the circulars issued by the CMA. From January 2012, it is mandatory for all entities licensed by CMA to have independent members on their board of directors and to present in their annual reports, any and all information, pertaining to board composition, activities, internal audit and financial matters. These entities must also employer corporate governance policies to encompass various areas of the board, including board membership criteria, authority of the board members, the ethical regulations covering employees and composition of audit and committees’ remuneration (King and Spalding, 2011).

1.2 Problem Statement

What importance of corporate governance has to Saudi stock market, while the majority of listed firms are private family-owned businesses? In addition, the shareholders and managers are often from the company's owners. In the same context of Saudi Arabia, the Saudi Stock Market face an unusual crash at the beginning of 2006, this led the Capital Market Authority (CMA) to stop the trading of two firms. These events created a serious question about the effectiveness of corporate governance that was presumed to protect investors' interests in Saudi Arabia (AL-Abbas, 2009). Traditionally, the market has been closed to foreigners. However, following the 2006 market correction, the authorities decided to increase demand for shares by further opening the market. Financial institutions and institutional investors from other Gulf Cooperation Council (GCC) countries and foreign legal residents are now allowed to invest directly in Saudi shares, and other foreigners can also do so via Saudi investment funds. The impact of these measures remains limited, with foreign trading representing less than 2% of the total during 2009. There is an on-going debate over whether the market should be further opened to investment from non-residents.

Therefore, in the Saudi stock market, the weak implementation of corporate governance standards led to a severe lack of foreign investment flows through the swap agreement with non-resident foreign persons, whether they are financial institutions or individuals. This is show through the balance of payments data of the Saudi economy, and the movement of capital for portfolio investment under capital and financial account. The Saudi economy did not live up to the flow of foreign investment for the Saudi market's minimum flows that are similar to some other neighboring regional markets. This is also due to the conviction of foreign investors about poor implementation of corporate governance, disclosure and transparency, as well as non-conviction of those investors about "SWAP Agreements" (Al-omri, & Balance of payments of the Saudi economy).

Corporate governance in Saudi Arabia became an issue of top concern among the business community and Saudi financial institutions to attract the largest possible number of foreign investments in the Saudi capital market. After millions of Saudis lost huge sums of money in the collapse of the financial market, the CMA realized the suffering of these people. The Capital Market Authority was quick to prevent recurrence, whereby it implemented new mechanisms, including the application of corporate governance standards of disclosure and transparency, and other measures to increase the size of the market by attracting foreign investments (Samba).

After several events that occurred over the past two decades, especially the financial collapses that occurred in a number of South East Asian and Latin American countries, there is transition to an open market system and pursuit of a policy of privatization. Due to the loss of confidence of foreign investors in these companies, the focus now is in the application of the concept of corporate governance.

Al-Tuwaijri (2010), the chairman of Saudi stock market has been invited by the investors of the New York Stock Exchange and informs them of investment opportunities in Saudi Arabia. He iterated that attracting foreign investment institutions to the Saudi financial market will remain a strategic objective of the

Commission, and announced that the Commission is considering new possible options to enable foreign investors to invest in Saudi companies. "We have a list of corporate governance and all contributions to companies applying the minimum corporate governance standards of disclosure and transparency to be updated regularly" (Al-Tuwaijri, 2010). The companies listed on the Saudi stock market will state in their annual reports that they applied standards of corporate governance. With these measures, it is hoped that Saudi Arabia can attract more American investments.

Al-Tuwaijri (2010) further stated that the lack of corporate governance led to the people who work in the company, such as managers, board members, or public officials, to loot the companies or public coffers at the expense of shareholders, creditors and other stakeholders (such as employees, suppliers , and the general public, etc.). In the current global economy, the increased suffering of the companies and countries with weak systems of corporate governance realize the seriousness of these implications. In addition, the companies suffered because of the scandals and financial crises. Thereby, the failure to attract high levels of foreign capital threatens the existence of the company itself, and can have severe effects on the economy of the whole country. Al-Tuwaijri (2010) added, 'we recognize that we still have a long way to go and more things to be done, we will continue our efforts to promote and increase the attractiveness of the market in Saudi Arabia, and we will strengthen the existing structure of corporate governance and the creation of new mechanisms to attract more foreign investment'.

On the other hand, Lee (2005) posited that the weak corporate governance will change the choice of foreign investors to prefer to invest in foreign direct investment

(FDI) rather than risk investing in portfolio investment, as FDI will be safer for foreign investors. Aggarwal, Klapper and Wysocki (2005), noted that foreign investors will choose the best companies which apply good corporate governance. Protecting the rights of investors will be bad for companies where the shareholders have the ability to control the confiscation of assets, because the mass of shareholders affect the value of the company and its management and thus impact the special benefits received by the foreign investors of the company. Yeh Hua and Woidtke (2005) found that board members who took control of companies belonging to the royal family had a negative effect on the protection of foreign investors. This is because it is difficult to know the degree of separation of management from ownership. They also noted this to be associated with a bad impact on the value of the company on the board of directors of family controlled companies.

1.3 Research Questions

In general, this study seeks to answer the following research question:

Is there any significant relationship between corporate governance structures (board size, independence) and audit committee (size, independence), firm age and firm size on foreign portfolio investment in the public listed companies (financial and non-financial)?

1.4 Research objectives

The Saudi code of corporate governance was issued by the Securities Commission and enacted since 2006; however, the concern that should be taken into consideration is whether the objective and purpose of such code can be achieved at a reasonable level. The corporate governance mechanisms have been recognized in varying degrees worldwide to have an impact on foreign portfolio investment. The main objective of this research is to determine the relationship between corporate governance structures (board size, independence) and audit committee (size, independence) and firm size and firm age, on foreign portfolio investment in the Saudi public listed companies (financial and non-financial).

1.5 Significance of the Study

This study is important, in that it deals with the contemporary issue of corporate governance in Saudi Arabia. Corporate governance contributes in many aspects to the economy, i.e., in raising the level of economic efficiency in Saudi Arabia, because it can help in stabilizing financial markets, and raise the level of transparency in Saudi companies, thus attracting foreign investors to invest in portfolio investment in Saudi Arabia. Besides this, it can reduce risks and build trust with foreign investors and protect their investments from exposure to loss, due to poor practice of corporate governance in Saudi Arabia.

Therefore, this study firstly, increases our understanding about the best practices of corporate governance structure in Saudi Arabia; secondly, it identifies the effect of corporate governance structure (board size, board independence, audit committee size, audit committee independence, firm size and firm age) on foreign portfolio investment. Specifically, the significance of this research is crucial to foreign investors. This research improves their understanding about which corporate governance practices can encourage them to invest in foreign portfolio in Saudi companies.

1.6 Scope of the Study

The scope of this study is as follows:

1- Financial and non-financial public listed companies which operate in the Saudi Stock Market (SSM); these companies have been selected due to the availability and accessibility of data to be collected in 2010.

2- The corporate governance variables focus only on board size, board independence, audit committee size, audit committee independence, firm age and firm size on foreign portfolio investment.

1.7 Organization of the Study

This study is divided into five chapters: chapter 2 provides the review of the literature and discusses previous literature about corporate governance and foreign portfolio investment. The third chapter explains the research methodology starting with framework, hypotheses development, variable measurement and data collection. Chapter 4 discusses the findings of the study. Chapter 5 provides the conclusion and discussion of this study, and provides suggestions and recommendation for future studies.

1.8 Summary

This chapter explain the background of the study and discusses the problem statement; in addition, it presents the research questions, research objectives, significance of the study, scope of the study; and organization of the study.

CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

There is a widespread interest in the concept of corporate governance and foreign investment. Many studies have been conducted in this area, which is shown in this chapter. Foreign portfolio investments in the financial markets received a great deal of attention and investigation at the global and local markets because of its impact on the economies of host countries, and in particular, developing countries. This chapter discusses these two topics. First: - review of previous studies regarding the dependent variable (foreign portfolio investment). Second: - The impact of corporate governance in attracting foreign portfolio investment.

2.2 Foreign Portfolio Investment

Literature proves that shareholders had great effect on the performance of companies. The governance of listed companies played a significant role in the decision making of foreign investment. Douma, et al. (2005), investigated the effect of foreign portfolio investment on the performance of companies in the markets, and observed that there are positive consequences of foreign ownership on the performance of the company. Additionally, they noticed the impact of foreign portfolio investment on the businesses. Aggarwal, et al. (2005) noted that foreign investors prefer firms with strong corporate governance. Investors need to protect their money in case of the badly managed companies, with shareholders who have the capacity to control the confiscation of assets. Block shareholders impact the value of the company and the impact on the personal benefits received from the company. Such companies find it costly to raise external funds. Yeh & Woidtke (2005) found that controlling boards of corporations with individuals, who belong to the family, and investor protection, are not satisfactory, and it is difficult to determine the level of separation of administration from owners. They also noted the negative impact on the value of company to board of managers controlled by members who are related to owners of companies. Li (2005) noted that weak corporate governance causes change in the selection of foreign investors to prefer foreign direct investment (FDI) rather than indirect portfolio investment, as it is generally believed that FDI has better protection.

Dahlquist, et al. (2003) examined foreign ownership and the company characteristics of a protected market in Sweden. They found larger presence of foreign investors in large corporations with good corporate governance and in companies that have large cash assets. They noticed that companies' size is driven by size of liquidity. Calculated in the presence of global lists of foreign sales, he stressed that foreigners have inclined to undersize companies with holders who have no control. Dahlquist, et al. (2003) measured international presence by foreign listings and export sale, and reiterated that foreigners tend to underweigh firms with a dominant owner. Covirg et al. (2006) concluded that foreign fund managers have scanty information about the local stock list of local fund managers. In addition, they also found that ownership of foreign funds is associated with the size of foreign sales, and the membership index and the list of stock with foreigners. Li and Jeong-Bon (2004) noted that foreign investors have an inclination to stay away from stocks with high reverse stock companies. They proposed that the Foreign Institutional Investors (FII) may produce better reports of information to attract Japanese companies with low-differentiation information.

Investors save less shares in companies with proprietorship structures that in companies commanded by insiders who control information access and availability of data to shareholders (Choe, Kho, & Stulz, 2004). With less information for investors, the foreign investors face the problem of adverse selection because of information asymmetry, even if they invest their money in these stocks. (Leuz, Nanda & Wysocki, 2003). Moreover, they confirmed that problems of information asymmetry led the investors to own fewer assets in companies.

Leuz, Nanda and Wysocki (2003) reiterated that information problems lead to foreigners holding fewer assets in firms. Thus, firm level characteristics can lead to information asymmetry problems. Concentrated family control makes it more likely that information is communicated via private channels. This is because of insiders have vested interests not to divulge benefits to outside investors. (Haw, Hwang & Wu, 2004) also discovered that other than the above, firm level factors also result in information asymmetry problems to FII. In their paper, they found that US investment is less in firms in which managers do not have effective control. Foreign portfolio investments in companies that rise to engage in the profitability management are more attractive, and less in poor countries with the weak framework of information. The best situation is in countries with monetary system and markets where the broader legal and political environment and economic development through sound policies, raises the benefits of both portfolio and direct investment.

Furthermore, Kim, Eppler-Kim, et al. (2010) investigated the impact of poor corporate governance on foreign portfolio investment and how good corporate governance is more likely to attract foreign portfolio investment (FPI) in the Korean market. They found foreign investors allow a disproportionately high percent of their investment to sizable companies and the companies which vote for foreign managers. Additionally, they showed, investors tend to invest more funds in firms with outside managers or outside directors. They proved there is a close relationship between corporate governance and portfolio investments by investors. Furthermore, foreign investors are anxious about corporate governance in Korean companies and the return of revenues for their investments (Dahlquist, et al. 2001).

In addition, the portfolio investors who are vulnerable to shocks persist in countries that provide strong protection for investors. Similar to this form of implicit structure, they found that the portfolio investors based in countries with weak protection of investors are more inclined to invest in foreign countries with strong protection of investors, and they hold equity, in particular, in some developing countries with strong investor protection. However, the shortage in the protection of investors is more suitable for the ownership of shareholders in a company. All foreign portfolio investors tend to avoid investing in a country where expropriation of minority shareholders is freely done, while the affluent investors are encouraged to become ruling investors by investing the biggest possible size of their money in the stock market in the country where the investor protection is weak (Mariassunta, et al. 2004).

In the same vein, Klapper and Love (2004) investigated how the good corporate governance is more convenient for invertors' protection; in addition, they found, that the level of companies applying corporate governance is important, especially, in countries which have poor protection of shareholders and weak judicial proficiency. They proposed that companies in countries which have poor protection of investors, have to improve the application of standards of corporate governance, which may increase companies' performance and their valuation.

The Organization for Economic Cooperation and Development (Kimberly, 2002), reported that foreign portfolio investment has helped to raise the amount of liquidity in the home capital market, including the evolvement of market proficiency. The market has become more liquid, greater and larger, and has a variety of financial funding investments. New businesses, for example, are more likely to start receiving the funds. Investors have a better opportunity for investment, whenever those investors are able to manage their portfolio investments or sell, if they need the money (Kimberly, 2002). Furthermore, the liquid markets will be more attractive to long-term portfolio investment. It is reasonable that portfolio investment has been performing in a disciplined and proficient way in local markets. For that reason, when investors look for new investment opportunities, they encounter several prerequisites, such as, the implementation of standards of corporate governance and accounting standards and best information quantity or quality, as well as finding out in what manner to work those standards in the financial markets in order to advertise transparency, which has a favorable effects in order to determine the decisions of investors. Foreign portfolio investment additionally is able to raise evolvement of fair markets and the stockholders' belief in corporate governance.

As firms compete, the market will perform better, with better opportunities for future accomplishment, and good corporate governance. As the liquidity of market and workability improve, equity values will grow to reflect the fundamental benefits of the companies, with better allocation of money flow. Well performing and fair markets takeover portfolio investment. Takeover markets know how to turn a badly managed company into an efficacious and more satisfactory and rewarding firm, supporting the firm, with fiscal revenue to its investors, as well as the local economy in well functioning equity markets, there can be takeovers, which is a point where there is an overlap of portfolio and direct investment. Poorly functioning firms can become efficient and more profitable via takeovers, hence strengthening the firm, as well as the financial returns to its investors, and the domestic economy according to **(**Kimberly, 2002).

Moreover, foreign portfolio investments might also assist the home capital market by way of the creation of advanced implements and methods to observe the portfolios. For example; they may bring with them a facility in using futures, options, swaps and other hedging instruments to manage portfolio risk. The growing demand for these instruments has led to the evolvement of this occupation in the local market and risk management provides better opportunities for foreign investors and local investors, to improve, in many ways, the above-named foreign portfolio investments, to reinforce local principal markets and their performance. This causes to a better allocation of wealth and funds in the local economy, and thus the health of the economy. Open capital markets are also conducive to economic development in the world with better rationalization of resources. Opening markets to foreign investors provides the opportunity to change their portfolios, improve risk management and support the strongest degree of savings and investment (Kimberly, 2002).

2.3 Foreign Portfolio Investment and Corporate Governance

Pursuant to agency theory, Jensen and Meckling (1976) said that corporate administrators or controlling shareholders insist on working and serving their advantages at the expense of foreign investors or those who are coming from outside the company or minority shareholders. Accordingly, when foreign investors buy shares in a company, they are in jeopardy of their investments because of the confiscation by corporate controllers or commanding shareholders (Klapper & Love, 2004). Notwithstanding the firm's performances in the past, there are other factors perhaps that incite foreign investors to provide money for firms, and in some instances, investors provide cash flow to firms in their investments and expect it to be protected from confiscation. Corporate governance is a set of procedures, rules, processes, standards and mechanisms, formulated or created and designed to protect foreign investors from managers of corporations (Daily et al, 2003; Ajinkya et al, 2005; Karamanou & Vafeas, 2005). As defined by the Organization for Economic Cooperation and Development OECD, Corporate Governance is "a set of relations among the administrators of the corporations and the Board of Managers and Shareholders".

Agency problems led to the financial scandals and corporate downfall of corporations, like Maxwell in the United Kingdom, Enron and WorldCom in United States, and Parmalat in Italy, The consequential result of corporate governance frameworks has received more concentration, especially, in the developing countries. For example, the Asian financial crisis of 1997–1998, disclosed the requirement for efficacious structures of corporate governance in these countries. In both the developed and developed countries, the symbols of corporate governance (e.g., Cadbury Committee, 1992; Blue Ribbon Committee, 1999; King's Report, 2002; Higgs Report, 2003) indicate that effective structures of corporate governance are consequential in the surveillance of the actions of corporate administrators, and consequently protect shareholders from confiscation. A wide range of earlier experimental investigation indicates that effective structures for corporate governance help to conciliate the advantages of managers with the benefits of shareholders

Wright (1996) stressed the importance of the role of corporate governance systems in achieving a higher degree of transparency and disclosure in the reports so as to enhance the confidence of investors on their investments in those companies with strong corporate governance systems. In the Arab region, there are many studies that have been carried out in this area, for example, by Hussein in 2003, who studied the structures of corporate governance in Bahrain, which is still in the initial stage.

Dahlquist et al. (2003) argued that the main concern is for the allotment of the portfolio, that should limit foreign investment by freely floating (the proportion of allocations not saved closely), and not in relation to market price, as well as to estimate the proportion of the shares for investment. In addition, they provided a set of evidence, at the country level and at the corporate level, to investigate the association between corporate governance and foreign investment. In comparison, another study at the corporate level for Swedish companies by Giannetti & Simonov

(2006) found that an external investor is less likely to invest in a Swedish company, if the Swedish control more incentives for foreign investors from expropriation.

Other studies also examined the result and impact of governance on foreign investment. Chan, Covrig, and Ng (2005) studied at the country level, and found that foreign investors avoid countries where the risk of government expropriation is high. In contrast to Chan, Covrig, & Ng (2005), Giannetti & Koskinen (2005) found investors invest in countries with good corporate governance and this is especially so in countries which protect the rights of investors.

Gelos and Wei (2005) found that growing markets with more transparency, in any country, hold gigantic weights in the flow of funds and portfolios. Ferreira & Matos (2007) found that foreign investors are inclined to invest in countries that have good practices for corporate governance and invest less in firms with a larger proportion of shares that are closely held. A common feature is that investors tend to measure foreign portfolio investment in relation to a firm's total equity market capitalization, rather than percentage of shares that are not closely held.

Dahlquist et al. (2003) found no link between corporate governance and foreign investment once the company managed to freely float. It does not necessarily mean that an association is not possible. It is possible that outside investors raise the flow of investment in companies, which are predicted to be strong with corporate governance and weak with poor corporate governance, resulting in no effect on aggregate. Moreover, it is practicable that these effects do not happen within the country but in some, but not all countries. So, any opportunity of foreign investors to react to poor governance is reasonable but low in countries with strong investor protection and strong in countries with good practices of corporate governance. Investors tend to adequately discount shares of companies with bad corporate governance, so that all investors get a good return for their investment, thus resulting in less expropriation.

Lemmon & Lins (2003), Nenova (2003), Doidge (2004), Klapper & Love (2004), Lang, Lins, and Miller (2004), and Kalcheva & Lins (2007) investigated if the reduced rates were enough for outside investors, considering they are facing the troubles of information and monitoring costs over the local investors. Furthermore, this investigation was unique to collect data on the structures of ownership and control rights from the inside of a large number of companies with comprehensive data on foreign investments of U.S companies. That study faced limitations because of the lack of data on the level of corporate governance and foreign investments as well as difficulty in obtaining data. Furthermore, they proved that it is significant to think about each company and the causes to explain whether the country and foreign investors stay away from poor corporate governance of companies.

Aggarwal et al. (2010) investigated the quotas of institutional shareholders and foreign investors in 23 states from 2003-2008 and their findings was that there is a positive association between foreign investment and the degree of performance of corporate governance. However, the origin the institutions is crucial; countries with powerful protection are more effective in promoting good governance, and when companies have legal system to protect shareholder, it plays a significant role to attract foreign investment. Companies with high institutional ownership are more likely to terminate the poorly performing CEOs, the results indicate that the portfolio of international investments by institutional investors support good practices of corporate governance in all parts of the world.

Allen & Chakrabarti (2007) explained India's monetary system, especially since the liberation era, and from that time, India's monetary system underwent a quick transformation in the banking industry and has moved from the era of government intervention to a more market-ruled system. It has seen growth in the benefits of liberalization with large inflow of foreign investment portfolio. However, three issues associated with the effect of the positions of international institutional investors. First, are alienated international investors holding these shares with a large disparity? Second, does the attitude toward inequality depend on the quality of corporate governance for foreign investors? Third, is the Asian monetary crisis a wake-up call to international investors from taking more weight to the problems of corporate governance in emerging markets? In addition, Lins (2003) explored these matters for a specimen of 2533 companies from 26 emerging markets; he proposed that investors prefer to hold fewer shares in firms with a dominant owner.

Another study discussed the Indian governance system, as well as how the system works to assist India's rise as a strong economy in the world, attracting foreign investors and protecting them (Chakrabarti, Meggison & Yadav, 2008). This paper advocated that the legal system in the country provided some protection to investors, but in reality, it involves slow over-burdened courts, and extensive corruption. As a result, a deeply condensed ownership and family business groups continue to control. Harabi (2007) found weak of performance in the implementation of corporate governance principles will lead to effect the foreign investment in Arab countries, due to various explanations, for example, controlling ownership of companies, the quality of corporate governance standards in the companies, and their implementation mechanisms. Dahlquist et al. (2003) found that the share of the stock market value of the country saved by the ruling shareholders is negatively associated with a share of stock in any country in the portfolio securities to investors in the U.S. Recent studies have experiment this view by using information of corporate governance level.

Previous studies considered the behavior of foreign investors with problems of corporate governance in developing countries. Others found that foreign portfolio investors want to invest their shares in firms with substitutes to ensure the resolution of disputes, which may be the most powerful alternative for the protection of the investor or to reduce the information asymmetry (Kang & Stulz 1997; Edison & Warnock 2003; Ahearne, Griever, and Warnock 2004). Others found that foreign investors reduced investment in the shares of companies which are (i) ruled by owners (Dahlquist & Robertsson 2001, in Sweden), (ii) high insider ownership (Kho, Stulz, and Warnock 2006), (iii) have poor domestic corporate governance, (iv) lack of transparency (Bradshaw, Bushee, and Miller 2004; Gelos & Wei, 2005; Aggarwal & Klapper (2005), (v) lack of international accounting standards (IAS), (vi) have poor protection of shareholder rights, or a weak legal framework (Aggarwal, et al. (2005). Existing studies investigated the interaction between the level of firm attributes (through-listing or ruling ownership) and levels of corporate governance quality (e.g., IAS, obligation of disclosure of all information, securities rules, or outside shareholder rights) using data on USA to investors' position in international firms (Ammer et al. 2006; Leuz, Lins, and Warnock, 2006). In the same study, the writer believed and documented the influence of varying ownership control in countries for purposes of foreign portfolio investments. Johnson et al. (2000) disputed that the risk of confiscation on shares of investors is higher during periods of decline or crisis.

In addition, Mitton (2002), Lemmon & Lins (2003), and Baek, Kang, and Park (2004) provided evidence that proved that Asian companies with altering power of the ownership of most of the companies saw a strong descent in stock prices during the Asian crisis. They studied the effect of modifying the variance on the ownership on accounting performance of company and stock valuation in the market; in general, they found negative results (La Porta et al., 1997; Claessens, Djankov, Fan, and Lang 2002, Lins, 2003). In addition, these studies had an impact to improve our knowledge and increase our understanding to know more about determinants of foreign portfolio investment. However, they did not study at all the impact of inequality in the ownership of companies on the local control holdings of shares from outside investors. It is an important part of the work of Giannetti & Simonov (2006), who considered the contrast control in the ownership of companies listed on the Swedish stock exchange, and analyzed their effect on the positions of foreign investors. They did not, however, examine the governance characteristics or how the board of companies affected portfolio choice of investors in the developing countries.

In addition, Grossman & Hart (1988) suggested concentrated proprietorship supported and solved the management agency problem that was originally studied by Jensen & Meckling (1976) because the ruling shareholders have the capacity to promote management discipline. Furthermore, Claessens et al. (2000) indicated that strengthened ownership causes new agency problems because of controlling the shareholders, and minority shareholders do not fully approve. La Porta et al. (1997) also indicated that the major shareholders have been seeking their benefits from minority shareholder's confiscation rather than to maximize the value of the company. Kim, et al. (2007) compared ownership and control in Korea and questioned about who is dominant in holding the real power, the earliest result associated to the Korean companies especially in Chaebols which was at the top of agency problems. Claessens et al. (2000) indicated the ultimate owners of the Chaebol subsidiaries ignored the advantages of minority shareholders. Ferris et al. (2003) noticed that Chaebol companies encouraged managers to make non-value maximizing capital of foreign investment decisions. Consequently, they take into their consideration that Chaebol is the suitable agent who reveals the high costs of the agency in Korea. It appears that there is a close association between corporate governance and foreign portfolios investment saved by foreign investors (Dahlquist et al., 2003) Foreign investors desire to invest in companies of the Chaebol, because most of those companies are undervalued, and foreign investors expect positive revenues from active sharing in good corporate governance.

In contrast, Fama (1980), and Fama & Jensen (1983) said that corporate boards know how to play a significant role in reducing the power of ruling shareholders to confiscate the benefits of minority shareholders. Perry and Shivdasani (2005) believed that it is more reasonable for a board controlled from the outside to participate in restructuring programs after the decline of performance, and the importance of these programs, Shivdasani & Yermack (1999) indicated the influence of chief executive in the selection of new board members. In addition, Shivdasani &

Yermack (1999), and Yeh, & Woidtke (2005) suggested that when senior executives are involved in the selection of managers, they choose directors who are less likely to monitor because of strong relation with these managers, that will have negative effects or lead to more agency problems.

Cotter et al (1997) and Perry & Shivdasani (2005) indicated that the close link between the observation of adverse board and management of foreign directors to investigate the efficiency of the board can play the roles expected. They have done numerous studies with a focus on the characteristics of the board, to a large extent, in terms of the size of the board (Yermack, 1996 and Eisenberg et al., 1998), the presence of independent directors (Byrd & Hickman, 1992) and board membership (Brickley et al., 1997). Moreover, a little bit is known about the relevance between the director's demographics and corporate governance. They also assumed that foreign directors are more likely to express their expertise independently of the members of the local board, and consequently, may serve as efficacious monitors. If so, foreign directors may be a more suitable factor for good corporate governance and therefore, foreign investors may surpass companies with foreign directors.

2.4 Company Characteristics

2.4.1 Company Size

According to Bartov et al. (2000), the failure to control contradictory variables led to falsely rejecting the hypothesis, when in truth, it should be acceptable. They were drawing from earlier investigations on foreign portfolio investment and controlling of a number of other variables that are probably the determinants of foreign portfolio investment. (Dahlquist and Robertsson, 2001; Jiang and Kim, 2004), gave evidence that support the positive association between foreign portfolio investment and the size of the company, as well as the level of profitability, and a negative association with the proportion of indebtedness. In addition, Lin and Shiu (2003) showed that liquidity linked positively with foreign portfolio investment. This study measures firm size by total assets of company.

2.4.2 Company Age

The rationale for choosing this variable is because mature companies have improve their practices and trainings and preparation of financial reports with time, and have become more transparent in their disclosures of financial reports, whether for investors, or any users of financial statements. In the original investigation of the company's age by Alsaeed (2006), he considered the degree of consequences of firm`s age on the optional disclosure of company, and he found there was no significant association between company age and the level of detection. Therefore, this study also examines if, there is any relationship between company age and foreign portfolio investments.

2.4.3 Board size

Drawing from Fama & Jensen (1983), a wide range of empirical evidence found that outside managers who are independent from controlling management help to raise shareholders' wealth via protection of the shareholders' rights against opportunistic management. Hermalin & Weisbach (2001), Beasley (1996), and Klein (2002), found that outside managers are effective in monitoring managerial processes. The size of the board is probably associated with the performance of the board, considering that the adding of more managers on board improves its knowledge base. The largest boards are less flexible and more effective. Given that boards in most public firms are fairly large (Yermack (1996). As for board size, Mangena & Tauringana (2007) found no association with foreign share ownership. These results show that the size of the board is not a significant element in the decision-making procedure for foreign investors.

2.4.4 Board Independence

Karamanou & Vafeas (2005) found several evidence that provide that there is a link between the market reaction and announcements of Board of Management's anticipations and characteristics of the Audit Committee, board independence and audit committee independence are positively associated with foreign portfolio investments, while board and the Audit Committee size are negatively associated with foreign portfolio investments. The evidence from these studies indicates that investors need more confidence in the predictions that are subject to scrutiny of what is perceived as the most common effective of corporate governance mechanisms.

2.4.5 Audit Committee Independence

The Blue Ribbon Committee expand the concept of directors' independence, which has to a large-scale, been applied to boards to emphasize that audit committees should be independent. The rationale is that, firstly, the independent directors working in the audit committees are likely to be free from influence of the management to ensure that financial information is transferred to the shareholders. Secondly, to monitor efficiently the quality of financial information that is disclosed by the company, committee members are supposed to have fundamental skills to intelligently explain the information correctly. The Blue Ribbon Committee indicates that audit committees must comprise directors who have knowledge, experience, are financially educated and at least one must be a member of the accounting body or possess financial management expertise, Bull & Sharp (1989) and Kalbers & Fogarty (1993).

2.4.6 Audit Committee Size

As for audit size, Mangena & Tauringana (2007) did not find a considerable association with the foreign portfolio investment. Meanwhile the results were positive, as predicted. These results show that the size of the audit committee is not a significant element in the decision-making process for foreign investors. Furthermore, the size of the committee probably has an impact on the performance of observation. Audit committees have greater and better knowledge base to design the performance of the company, but it can suffer from the loss process and spreading of responsibility. In fact, audit committees usually consist of four to five members at least (Klein, 2002), and that led the Blue Ribbon Committee to indicate that audit committees must have at least three members, as a minimum. (Menon & Williams,1994).

2.5 Summary

This chapter summarizes the previous studies in relation to the scope of this study, where a literature of previous studies on the dependent variable (foreign portfolio investment), and literature of previous studies related to corporate governance, in addition, to literature on six independent variables are given.

CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Introduction

Chapter 2 reviewed studies which had been carried out in various countries, in attempts to examine the link between the board and audit committee features (independent variable) and the foreign portfolio investment (dependent variable). The present chapter deals with the three important sections of this study: the theoretical framework in the verification of the link between corporate governance structure and portfolio investment, hypotheses development and finally, methodology.

3.2 Conceptual Framework

The present study's theoretical framework is based on agency theory as its basis. A majority of the policy makers and scholars are unanimous on the fact that the economy of an emerging market is boosted by the influx of foreign capital sources. Accordingly, Aggarwal et al (2005) indicated that in the emerging markets, foreign capital has a key role in the promotion of their economy through the development of financial systems and good implementation of corporate governance.

Some studies suggest that corporate governance affect the portfolio investment (Obstfeld and Rogoff 2001; Martin and Rey 2004; Lane and Milesi-Ferretti 2008). Finance scholars have investigated the role of corporate governance in portfolio investment. As Shleifer and Vishny (1996) put it, "corporate governance deals with the ways in which suppliers of finance to corporations assure themselves of getting a return on their investment.” Thus, when corporate governance is weak, the portfolio investors are not protected and they are afraid of the expropriation by controlling shareholders. In the same case, portfolio investors will avoid investment in firms with weak corporate governance.

Previous empirical studies provided evidence that foreign portfolio investors may invest less in a company with poor corporate governance. For example, Aggarwal, Klapper, and Wysocki (2005) found that U.S. portfolio investors invest less in emerging markets with weak shareholder protection. Leuz, Lins, and Warnock (2009) also indicate that U.S. portfolio investors invest less in foreign companies with highest levels of managerial controls, when the company is in a country with poor protection for investors. Furthermore, a study by Giannetti and Simonov (2006) found that international investors are unwilling to invest in Swedish companies due to weaker corporate governance. In addition, Kim, Sung, and Wei (2007) indicated that corporate governance of a company might not be a concern for a certain kind of foreign investors. Even though the abovementioned literature provided important information into the role of corporate governance in foreign portfolio investment, most of the studies focused on one country or a specific organization as their subjects. In addition, as Kim, Sung, and Wei (2007) showed, it is not clear whether foreign investors are also concerned about weak corporate governance of host countries.

According to Beach (2006), emerging market equities are categorized into a global diversified portfolio investment because the returns from the emerging market investments will result in enhancing the risk/return profile of the portfolio. Moreover, Anderson et al. (2001) contended that foreign investment within transitional economies will result in enhancing corporate governance and efficiency.

Foreign investors need to forecast the possible benefits to their portfolio investment, as well as the risks, such as political instability, inefficient legal systems and corporate governance challenges within the emerging markets, prior to investing in them (La Porta et al., 1999; Shleifer & Vishny, 1996). In addition, corporate governance has close ties with foreign portfolio investment (Dahlquist et al., 2003). For instance, Ararat & Ugur (2003) revealed that for emerging nations such as Turkey, higher levels of corporate governance may result in a pull effect attracting international funds. On the other hand, weak corporate governance may result in a push effect detracting international funds. Similarly, Bae et al. (2003) revealed that corporate governance quality impacts the distributional feature of stock returns between emerging markets. For instance, in the Asian Crisis of 1997-1998, the emerging markets that were open to capital flows were all impacted. Also, Johnson et al. (1999) claimed that weak corporate governance was the reason behind the severe crisis. Therefore, if foreign investors decide to invest in emerging markets, investors should take corporate governance into consideration.

According to Gillan (2006), the board of directors is the main element of corporate governance as it is responsible for advising and monitoring management and with hiring, firing and compensating the senior management team. Hence, it is imperative that the board acts in line with effective corporate governance (Guan et al., 2007). Although the board of directors is linked to corporate governance, prior studies concerning foreign ownership only studied the relationship between foreign ownership and firm-specific features like size, returns, systematic risk, idiosyncratic risk, leverage, current ratio, return on assets and book-to-market (Kang & Stulz, 1997; Lin & Shiu, 2003). In addition, according to Dahlquist & Robertsson (2001) foreign investors desirous of investing in the management of the firm and influencing it could employ their votes at the shareholders' meeting and keep well away from firms having high concentrated ownership. Board ownership is among the many important board controlling tools along with board size, compensation and dual leadership. For the protection of their investment in firms, foreign institutional investors require transparency and efficient working of the corporate governance system.

The audit committee, as a governance mechanism, is responsible for the reduction of information asymmetry between stakeholders and managers, and hence, decreasing agency issues and to their part as the overseeing body, the audit committee must monitor effectively, as emphasized by the current governance suggestions and regulations. The agency perspective contends that an effective audit committee carries out an overseeing role when it is independent of management and is in possession of financial and industrial experience to actively oversee internal controls and financial reporting process (Carcello, et al. 2006).

In the context of China, the audit committee's monitoring role is important owing to the weak legal protection whereby minority shareholders suffer through the expropriation by the dominant shareholders like the government/state. However, based on some studies (Aguilera & Jackson (2003); and Doidge et al., 2007), the characteristics of the country explain more of the uniqueness of the governance than the firm level features ever could. According to Jensen & Meckling (1976), corporate managers or controlling shareholders act to their benefit and not to the benefit of both the external investors and minority shareholders. In other words, outside investors face the risk of failure of returns on investments owing to the expropriation by corporate managers or majority/dominant shareholders (Klapper & Love, 2004). In view of this agency problem and in the face of the high-profile financial scandals and failures like Maxwell in the U.K., Enron and WorldCom in the U.S. and Parmalat in Italy, certain committees and reports (Cadbury Committee, 1992; Blue Ribbon Committee, 1998; and King's Report, 2002) recommend effective corporate governance structure to monitor the corporate managers' activities to protect the shareholders from expropriation. It has been evidenced in the literature that effective corporate governance structures assist in aligning managers' interests with shareholders' interests and evidence also reveals a negative link between investment and both board size and audit committee size (Karamanou & Vafeas, 2005).

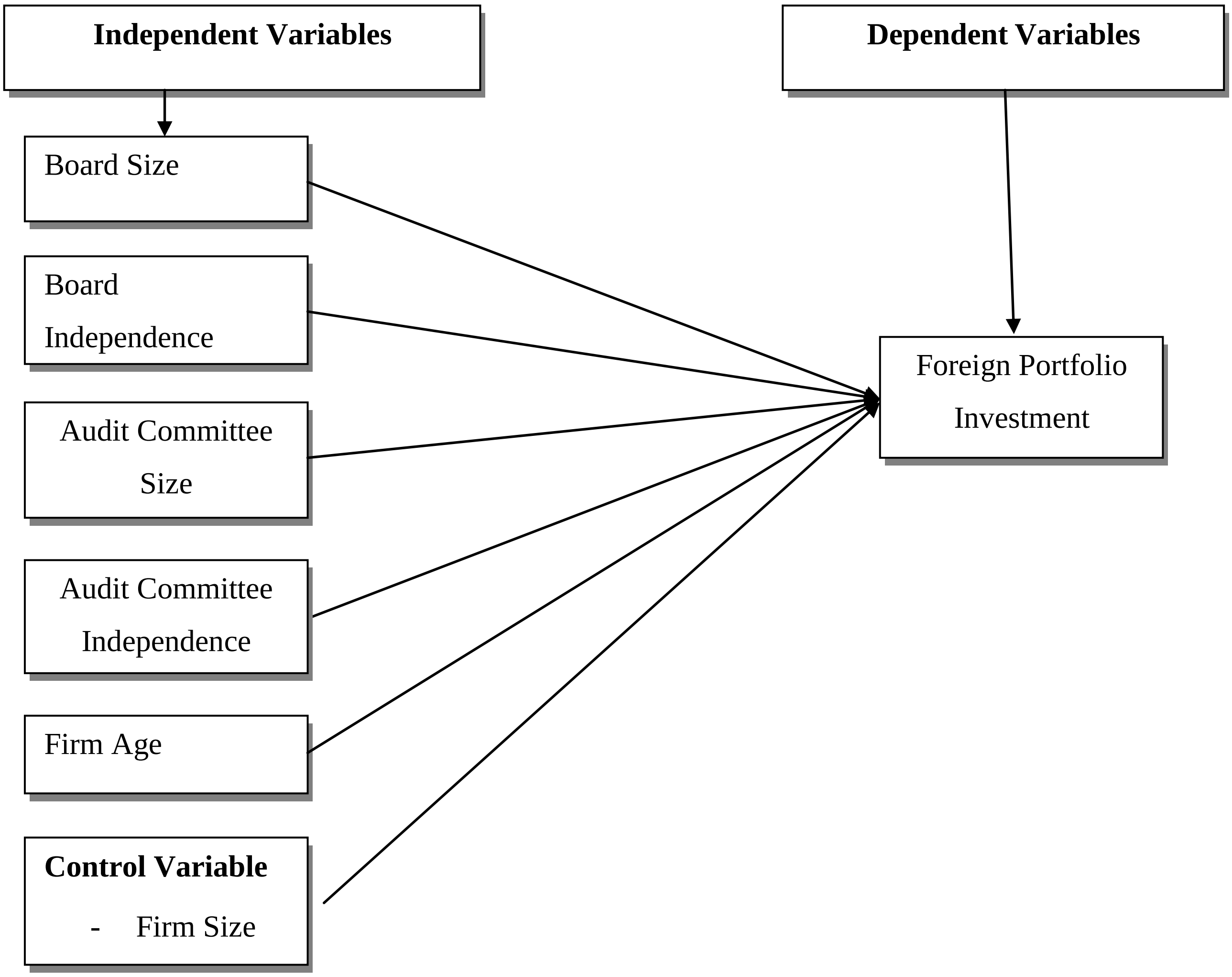

Figure 3.1 Research Framework

3.3 Hypotheses Development

The present study presents how independent variables like board and audit committee size, influence foreign portfolio investment. The study carries out an examination of the impact of corporate governance variables with foreign portfolio investment in Saudi Arabian listed companies.

3.3.1 Board Size and Foreign Portfolio Investment

The previous body of research has studied board size and considers it as one of the key governance features although the findings are inconclusive regarding the size of effective boards (Eisenberg, Sundgren & Wells, 1998; Yermack, 1996). Board size is generally viewed as a governance feature that impacts the ability of the board to monitor as larger boards are usually considered to be more effective.

Board size refers to the number of members in the board. However, a big board has also been known to have coordination and process issues; a larger board may not effectively monitor management owing to the coordination and process issues that are typical in large team sizes (Jensen, 1993). Empirical studies have been carried out to validate this fact but results are often inconsistent except Yermack's (1996) findings which reinforces Jensen's (1993) contention.

Similarly, some previous studies found a negative link between portfolio investment and board size. Mangena and Tauringana, (2007) failed to establish a significant link between board size and foreign portfolio investment, although the coefficients are positive. These results point to the assumption that board size should not be taken into consideration in the foreign investor's decision process which is contrary to what is suggested in the literature (e.g. Karamanou & Vafeas, 2005; and Mangena & Pike, 2005).

Eisenber et al. (1998), revealed a significant negative link between board size and small and mid-size firms' profitability. Other studies (Yermack, 1996, and

Eisenberg & Sundgren, 1998), found no such link. Even with the ambiguity in the board size's impact upon control mechanism, the following tentative hypothesis is developed:

H1: There is a relationship between board size and foreign portfolio investment in Saudi firms.

3.3.2 Board Independence and Foreign Portfolio Investment

The board of directors comprises both external and internal directors. The former are individuals serving on the board but not acting in any form of executive capacity. Jensen & Meckling (1976) argued that boards comprising a majority of outsiders or non-executive directors (NEDs) may be effective in avoiding agency problems through monitoring and controlling of management's opportunistic activities. In reality, policy makers have made it mandatory to appropriate seats for independent directors in order to protect the external shareholders' interests. In the body of knowledge, Fama & Jensen (1983) stated that external directors are offered with incentives in order to create a good reputation as experts in their field of monitoring owing to the human capital value's dependence on it. A majority of the research agree with the external directors' effectiveness in upholding the interests of shareholders (Weisbach, 1988; Byrd & Hickman, 1992; and Park & Shin, 2004). Some of them do not agree with the rationale (Mallette & Fowler, 1992; Mallette & Hogler, 1995; and Klein, 1998), and others go against it (Singh & Harianto, 1989; Agrawal & Knoeber, 1996). Based on the discussion, the following hypothesis is formulated:

H2: There is a positive relationship between board independence and foreign portfolio investment in Saudi firms

3.3.3 Audit Committee Size and Foreign Portfolio Investment

There is little research exploring the importance of audit committee size, the findings of which are fragmented. It can be assumed that a large sized audit committee may be more effective on foreign portfolio investment, but Mangena & Tauringana (2007) found no significant link between foreign share ownership and audit committee size, even though the coefficients turned out positive as predicted. In other words, a larger committee may be more capable of attracting investment from an extensive range of experience. Accordingly, a larger sized committee may be more effective in foreign investments. As a result of this mixed findings, the following hypothesis is:

H3: There is a relationship between audit committee size and foreign portfolio investment in Saudi firms.

3.3.4 Audit Committee Independence and Foreign Portfolio Investment

An independent audit committee has been the focus of a majority of audit committee studies although the findings are not unanimous. The audit committee effectiveness improves over time. This requires creating an independent audit committee under the board of directors in accordance with the Code of Conduct for all listed firms and internal control mechanisms. Hence, it can be stated that the State is effective in facilitating mandatory compliance with Chinese corporate governance code.

With respect to corporate governance, Mangena & Tauringana (2007) results indicate that foreign portfolio investment is positively associated with audit committee independence. (Chambers, 2005), has emphasized the role of audit committee. It is more likely that an independent audit committee is more capable of protection of investors. Owing to the weak governance controls and the ineffective minority shareholders' protection in China, the independent directors in the audit committee are more likely to effectively monitor Chinese firms listed in Hong Kong.

According to Muniandy (2007) the auditor's assessment of the risk in Malaysian firms is affected by the audit committee's independence. Therefore, it can be stated that various institutional settings form the need to justify the results in further research highlighting differing settings. The following hypothesis is:

H4: There is a positive relationship between audit committee independence and foreign portfolio investment in Saudi firms.

3.3.5 Firm Age and Foreign Portfolio Investment

The old companies may have more experience dealing with stakeholders and may realize the value of good corporate governance and disclosures to improve their performance and image. Alsaeed (2006) examined the company age in relation to voluntary disclosure; he does not find any relationship with voluntary disclosure. Camfferman & Cooke (2002) suggested that age of company should be investigated since older companies might have improved their financial reporting practices over time. The following hypothesis is:

H5: There is a relationship between firm age and foreign portfolio investment in Saudi firms.

3.4 Research Design

3.4.1 Sample and Data Collection

This research makes use of secondary data collected from the firms' annual reports. Data is also collected from existing sources like websites of the firms. This study's population comprises financial and non-financial firms listed in the Saudi Stock Exchange (www.Tadawul.com.sa). There were 80 companies (57 non-financial companies and 23 financial companies) listed on the Saudi stock exchange during 2010. This period is chosen because it is the latest source of available information provided by the companies at the time of this study.

3.4.2Data Analysis

The analysis of the data is undertaken using different procedures. In the first part, descriptive statistics such as mean, standard deviation, percentage, and frequencies were obtained using SPSS program. To test the association between the dependent and independent variables, linear regression is utilized. This test is used because the dependent variables are continuous in nature.

3.4.3 Model Specification and Analysis

The following ordinary least square (OLS) regression model is applied to examine whether foreign portfolio investment is influenced by corporate governance:

$FPI = \alpha + \beta 1BSIZE + \beta 2BIND + \beta 3ACSIZE + \beta 4ACIND + \beta 5FMAGE + \beta 6FMSIZE + \varepsilon$

Where;

FPI	=	Foreign Portfolio Investment.
α	=	Constant.
$\beta 1BSIZE$	=	Board Size.
$\beta 2BIND$	=	Board Independence.
$\beta 3ACSIZE$	=	Audit Committee Size.
$\beta 4ACIND$	=	Audit Committee Independence.
$\beta 6FMAGE$	=	Firm Age.
$\beta 5FMSIZE$	=	Firm Size.
ε	=	Random Error.

3.5 Measurement of Variables

The following section explains the measurement of variables for the study.

3.5.1 Dependent Variable

As mentioned earlier, the dependent variable is the foreign portfolio investment defined as foreign ownership held by foreign investors. It is measured as the foreign investors' percentage of shareholding at the end of the financial year as supplied in the Saudi Stock Exchange (Mengena & Tauringana, 2007; Andersen et al., 2001). Therefore, in this study FPI is measured as the percentage of common shares of foreign investors.

3.5.2 Independent Variables

3.5.2.1 Board Size

Based on Mangena & Tauringana (2007) board size can be measured as the total number of board members of each firm including the CEO and the Chairman at the year of the annual report.

3.5.2.2 Board Independence

The independence of the board is measured by proportion of outsider members to the total number of board members (Kyereboah-Colemn and Biekpe, 2006).

3.5.2.3 Audit Committee Size

The audit committee size is measured as the total number of directors in the audit committee at the date of the annual report (Mangena & Tauringana, 2007).

3.5.2.4 Audit Committee Independence

The audit committee independence is measured as the proportion of independent members in the audit committee to the total number of members of the committee at the annual report date (Mangena & Tauringana, 2007).

3.5.2.5 Firm Age

Age is calculated by the natural log of the number of years that a company has operated. Hence, firm age is measured through the number of years that the company has performed since incorporation (Loderer & Waelchli, 2009).

3.5.3 Control Variables

3.5.3.1 Firm Size

While firm size can be measured in various ways like total assets, turnover, number of employees, total assets used and the firm's average market value (Carven & Marston, 1999), the present study measures firm size as the total assets the company used.

3.6 Chapter Summary

This chapter explains the study framework, presenting corporate governance characteristics' impact upon portfolio investment of companies listed on the Saudi Stock Exchange (Tadawul). The hypotheses imply that these corporate governance features impact foreign portfolio investment of Saudi non-financial companies listed in Tadawul. Moreover, controlling factors such as size of firms is also considered.The methodology of the study is also described in this chapter. Secondary data was used for financial and non-financial companies listed in the Saudi Stock Exchange during the period 2010 which represented the study population. Foreign portfolio investment is the dependent variable while the independent variables are board size, board independence, audit committee size, audit committee independence and firm age. The control variable is firm size which is argued in literature as having an impact over the foreign investment portfolio of firms.

CHAPTER FOUR

FINDINGS AND ANALYSIS

4.1 Introduction

The chapter presents the results of the study. In the first part of the chapter, the descriptive statistics are discussed. It includes a discussion of the maximum, minimum and mean and standard deviation. In Section4.2, the regression assumptions are discussed. In the following section, section 4.3 the results of regression analysis are provided. This chapter concludes in section 4.4.

4.2 Descriptive Statistics

A summary of descriptive statistics of foreign portfolio investment in Saudi Arabia is presented in Table 4.1.all 80 firms are the subjects of this study. This descriptive statistics indicated that the level of foreign portfolio investment has an average of 0.094275. Board independence raises from 0% to 90% indicates that some boards are usually independent and some are not. This suggests that some companies do not comply with the code of corporate governance issued by Saudi Securities Commission that requires at least one-third of board members to be independent.

Table 4.1

Descriptive Statistics

	N	Minimum	Maximum	Mean	Std. Deviation
FPI	80	.000	.649	.094	.152
BIND	80	.000	.900	.492	.217
BSIZE	80	4	13	8.74	1.667
AUDSIZE	80	2	6	3.39	.703
AUDIND	80	.000	1.0000	.443	.310
FIRMAGE	80	1	35	18.07	9.020
FIRMSIZE	80	7.249	11.987	9.581	1.136

The overall results indicate that less than half of the board members are independent. As for the board size, Table 4.1 shows that size of board ranges from four to 13 directors, which suggests that number of board members, in some cases, exceeds the suggested figure (8 to 9 directors), as suggested by literature for effective boards. This result is consistent with study of Okeahalam (2004). Taking the mean of board size, it can be seen that on average, the board size is about eight directors which falls within the limit suggested by literature.

In respect, the audit committee independence has a maximum average of 100% independent members, which indicates that some audit committees have full audit independence. The score is 0% members, which suggests that some companies did not comply with the code of corporate governance issued by the Saudi Securities Commission that requires all of the audit committee members to be independent. The results above shows that audit committees have less than half independent directors. Such results comply with the regulation that audit committees should comprise a majority of independent directors. In addition, the table shows the size of audit committee ranging from two to six audit members which shows that the audit committee exceeds the suggested number (3 to 4 members) found in the literature for efficient boards. For firms' size, the sample of study has average total assets of 9.581 billion (Saudi Riyals) with the maximum of 11.987 billion (SAR). Lastly, for firm age, the average is 18.07 years with the maximum of 35 years.

4.3 Pearson's Correlation Matrix

Table 4.2 shows Pearson's Correlation Matrix for all explanatory variables. The results reveal several significant relationships between the dependent variable and independent variables, as well as among independent variables. Usually, the indications of multicollinearity exceed the limits determined by researchers. According to Lind et al. (2008), multicollinearity exists when the correlation between two independent variables is between -0.70 and 0.70. As shown in the table, there are few correlations between the variables in the model at 1% and 5% levels of significance; however, such cases still are within the range which does not pose any problem of multicollinearity.

A high level of correlation is shown between the foreign portfolio investment and audit committee independence at 65.2% level of correlation at 1 % level of significance. In addition, there is correlation between foreign portfolio investment and board independence at 58.2%. Moreover, there is a correlation between control variable, firm size and foreign portfolio investment with 61.6%. Other significant of were found between audit committee independence and board independence

(63.6%), firm size and audit committee independence (47.7%), firm size and board independence (42.5%), but still within the acceptable level. All other variables are not correlated. Therefore, VIF test was used to see whether the multicollinearity assumption is met. Based on the results shown in Table 4.3, VIF is below two. It can be said that the multicollinearity assumption is met. Based on Hier et al (2010), VIF should be less than 10.

Table 4.2
Correlations

	1	2	3	4	5	6	7
1) FPI	1						
2) BSIZE	.058	1					
3) BIND	.582**	.206	1				
4) AUDSIZE	-.146	.066	-.143	1			
5) AUDIND	.652**	.118	.636**	-.149	1		
6) FIRMSIZE	.616**	.160	.425**	-.035	.477**	1	
7) FIRMAGE	-.261*	-.023	-.190	.103	-.233*	-.093	1

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

* Correlation is significant at the 0.05 level (2-tailed).

4.4 Multiple Regression Results

4.4.1 Model

From the results of OLS model in Table 4.3, it can be seen that the R Square is .591, and adjusted R square is.558. This result statistically supports the significance of the model as it implies that the independent variables explain 59% of the predicted dependent variable. This is an acceptable result and consistent with previous studies (e.g., Karamazov & Vafeas, 2005; Mangena & Pike, 2005 and Mangena, & Tauringana, 2007).

4.5 Regression Results

This section is regarding the regression results for the relation between corporate governance and foreign portfolio investment. As shown in Table 4.3, the data coefficients are described as follows: board size has standardized beta coefficient equal to -0.084 and t-value of -1.085; there is no significant relationship between board size and foreign portfolio investment significance at 0.281. Board independent has a beta coefficient of 0.213 and an average t-value equal to 2.124 with significance at 0.037, meaning that there is significant association with foreign portfolio investment. The third variable, audit committee size has a beta value equal to -0.038 and a t-value of -0.499, and the significance equal to 0.619. This finding shows there is no relationship between audit committee size and foreign portfolio investment. The fourth variable, audit committee independence has a beta value equal to 0.315 and a t-value of 3.053, and the significance equal to 0.003. This result indicates a positive relationship between audit committee independence and foreign portfolio investment, meaning that foreign portfolio investments increase with more member independence of audit committee. Finally, the last variable, firm age has a beta value equal to -0.110 and t-value of-1.427, and the significance equal to 0.158. Therefore, firm age has no significant association with foreign portfolio investment.

Table 4.3

Regression results

Model	Beta	T	Sig.	VIF
(Constant)	-.402	-3.226	.002	
BSIZE	-.008	-1.085	.281	1.063
BIND	.149	2.124	.037**	1.794
AUDSIZE	-.008	-.499	.619	1.043
AUDIND	.154	3.053	.003 ***	1.897
FIRMAGE	-.002	-1.427	.158	1.066
Control var. FIRMSIZE	.050	4.340	.000***	1.353
R	**.769[a]**			
R^2	**.591**			
Adjusted R^2	**.558**.			
F value	**17.602**			
F Significant	**000[a]**			

a. Dependent Variable: FPI

b. * sig at 10%

** sig at 5%

*** sig at 1%

c. FPI = -0.402 + -0.008 BSIZE + 0.149 BIND + -0.008ACSIZE+ 0.154ACIND + -0.002FMAGE+ 0.050FMSIZE

Based on the above results of (table 4.3), the following can be concluded at (Table 4.4): The board size has no significant relationship in affecting foreign portfolio investment. Therefore, hypothesis one is not supported, while hypothesis two is supported, where the board independence has a significant relationship with foreign portfolio investment. In terms of the third hypothesis which is related to audit committee size, it is shown that audit committee size has no significant relationship with the foreign portfolio investment. Hence, the third hypothesis is rejected. Moreover, based on these results shown in the multiple regression analysis, the fourth hypothesis is supported. The result shows the audit committee independence, has the highest significant relation in affecting foreign portfolio investment. With respect to the fifth variable, firm age, it is evident that no impact is revealed on foreign portfolio investment. This result provides no support for the fifth hypothesis. For the control variable such as firm size, it is evident there is a relationship with foreign portfolio investment.

Table 4.4
Summary of findings

No.	**Measures**	**Significance of Relationship**	**Hypothesis**	
1	Board size	No significant relationship	H1	Not supported
2	Board Independence	Significant relationship	H2	Supported
3	Audit committee size	No significant relationship	H3	Not supported
4	Audit committee independence	Significant relationship	H4	Supported
5	Firm age	No significant relationship	H5	Not supported

4.6 Summary

From the discussion above, the results show mixed evidence on the relationship of corporate governance mechanisms on foreign portfolio investment. As summarized in the Table 4.3, the only mechanisms that have impact on foreign portfolio investment are the board independence and audit committee independence. The other mechanisms have no impact on foreign portfolio investment and that may be due to the late mandating of corporate governance and it is difficult to see the real impact of corporate governance mechanisms.

CHAPTER FIVE

CONCLUSION

5.1 Introduction

This chapter provides a summary of the main results of the study. Besides, the limitations and suggestions for future research are also provided. Furthermore, the contribution of the study is reemphasized and finally the implications of the study are discussed.

5.2 Discussion of Results

This study examines the relationship between selected corporate governance variables such as board size, board independence, audit committee size, audit committee independence and firm age on foreign portfolio investment in the list of Saudi companies in year 2010.

The regression results also indicated there is a relationship between selected corporate governance variables such as board independence, audit committee independence and foreign portfolio investment. As shown in the table (Table 4.3), the results are quite interesting since some of corporate governance variables seem to have good impact on foreign portfolio investment. From the results above, it is indicated that board size and audit committee size do not have significant relationship with foreign portfolio investment, in which, they do not affect the foreign investor's decision. This result is consistent with results found by Mangena and Tauringana, (2007). These results suggest the assumption that size of board or audit committee should not be taken into consideration in the foreign investor's decision process which is contrary to what is suggested in literature (e.g. Karamanou and Vafeas, 2005; Mangena and Pike, 2005).

For other variables, it was found that board independence, and audit committee independence have positive association of foreign portfolio investment; this suggests that foreign investors perceive independence of board or audit committees as free from the influence of management and therefore more likely to ensure that shareholders are provided with quality and credible financial information. This is consistent with the literature (e.g., Karamanou & Vafeas, 2005; Mangena & Pike, 2005) and corporate governance codes (e.g., Cadbury Committee, 1992; King's Report, 2002) suggesting that independence of board or audit committees are more effective monitors of the financial reporting process. For the fifth variable, the result shows there is no relationship between firm age and foreign portfolio investment. With respect to the control variable, the results show that firm's size is significant to foreign share ownership.

5.3 Issues of the Study and Key Findings

Towards the end of the past century and the early parts of this century, varying financial scandals involving corporate governance issues have manifested, along with controversies by researchers, regulators and practitioners. In such an environment, many countries have carried out a series of reforms in the hopes of enhancing the management and governing of corporations. This led to the recommendations and best practices of corporate governance to be mandated in a global scale. Saudi Arabia is no different; following the various countries' practices, it has issued guidelines in 2006 on corporate governance practices and mandated that all Saudi listed firms comply with the said practices.

The aim of the present study is the examination of the effect of selected code of corporate governance mechanisms including the impact of board size, board independence, audit committee size and audit committee independence upon foreign portfolio investment. The present study involves 80 firms which are chosen based on the availability and accessibility of data collection in 2010. In addition, secondary data regarding the firms is collected through their annual reports and existing sources including websites. The population consists of financial and non-financial firms listed in Tadawul – the Saudi Stock Exchange.

The present study attempts to answer the following question:

> Is there any significant relationship between corporate governance mechanisms and firm size on foreign portfolio investment in the public listed companies?

In order to find the answers to this question, five hypotheses are developed and tested. The findings from the regression analysis reveal that corporate governance mechanisms do have a relationship with foreign portfolio investment with the exception of board size, audit committee size and firm's age. The findings also reveal that board independence and audit committee independence both have positive relations with foreign portfolio investment.

5.4 Limitations and Recommendations for Future Research

There are some limitations which have been documented in this study, which can be used as suggestions for future studies.

1- This study used both financial and non-financial companies. Therefore, for future studies, it will be good to focus on one sector, i.e., financial companies or non-financial companies, as well as, to see the effect on one sector.
2- This study employed 80 firms to examine foreign portfolio investment for only one year 2010; more satisfying results could be achieved if the study period is analyzed for more than a year.
3- Future research can be conducted in this field of study using the same population and improving the design of the study. In other words, the future research can be conducted using more comprehensive variables of corporate governance, and other independent variables which can be examined in this area, such as culture, or cost of equity, which may influence foreign portfolio investment, not just factors that have been chosen and examined in this study.
4- It might be necessary to conduct future research in different countries as there are many differences in cultures and level of implementation of corporate governance, etc. Further study could extend the corporate governance variables and other variables on foreign portfolio investment.

5.5 Contribution of Study

The primary objective of the present study is to provide evidence of the relationship between the corporate governance mechanisms and foreign portfolio investment in Saudi listed companies. The field of study dedicated to the area lack empirical evidence regarding corporate governance and foreign portfolio investment in Saudi firms. The present study's findings can establish evidence to the hypotheses and provide an invaluable insight for the Saudi Securities Commission regarding the effectiveness of the code of corporate governance upon foreign portfolio investment in Saudi public companies. These findings may also guide the said Commission in taking steps to improve the corporate governance implementation and in turn, attract greater foreign portfolio investment into the country. The study's findings also contribute to the knowledge and literature in the realm of corporate governance and foreign portfolio investment.

5.6 Conclusion

The main objective of the study was to determine if there is any relationship between corporate governance structures on foreign portfolio investment. In general, the results reveal that; first, there is no significant relationship between board size and foreign portfolio investment significance. Second, Board independent has a significant association with foreign portfolio investment. The third variable, audit committee size has no relationship with foreign portfolio investment. The fourth variable, audit committee independence has a positive relationship between audit committee independence and foreign portfolio investment, meaning that foreign portfolio investments increase with more member independence of audit committee. Finally, the last variable, firm age has no significant association with foreign portfolio investment. Specially, this study examines if each of the selected code of corporate governance characteristics led to attract foreign portfolio investment of Saudi public listed companies (financial and non-financial). However, the regression result does indicate that the other variables of corporate governance structures i.e. board size and audit committee size and firm age do not influence foreign portfolio investment. In addition, the others selected code of corporate governance characteristics led to attract foreign portfolio investment to Saudi Arabia.

References

Aggarwal, R., Erel, I., Ferreira, M., & Matos, P. (2010). Does Governance Travel Around The World? Evidence From Institutional Investors. *Journal Of Financial Economics, 100*(1), 154-181.

Aggarwal, R., Klapper, L., & Wysocki, P. D. (2005). Portfolio Preferences Of Foreign Institutional Investors. *Journal Of Banking & Finance, 29*(12), 2919-2946.

Agrawal, A., & Knoeber, C. R. (1996). Firm Performance And Mechanisms To Control Agency Problems Between Managers And Shareholders. *Journal Of Financial And Quantitative Analysis, 31*(3), 377-397.

Aguilera, R. V., & Jackson, G. (2003). The Cross-National Diversity Of Corporate Governance: Dimensions And Determinants. *Academy Of Management Review, 28*(3), 447-465.

Ahearne, A. G., Griever, W. L., & Warnock, F. E. (2004). Information Costs And Home Bias: An Analysis Of US Holdings Of Foreign Equities. *Journal Of International Economics, 62*(2), 313-336.

Ajinkya, B., Bhojraj, S., & Sengupta, P. (2005). The Association Between Outside Directors, Institutional Investors And The Properties Of Management Earnings Forecasts. *Journal Of Accounting Research, 43*(3), 343-376.

Al-Abbas (2009). Corporate Governance and Earnings Management: An Empirical Study of the Saudi Market. *The Journal of American Academy,* 15 (1)1540 - 1200

Allen, F., Chakrabarti, R., & De, S. (2007). India's Financial System.

Al-Omari, (2011), Foreign Investors are Reluctant to Invest in the Saudi Market, retrieve from (www.abdulhamid.net/archives/2166).

Alsaeed, K. (2006). The Association Between Firm-Specific Characteristics And Disclosure: The Case Of Saudi Arabia. *Managerial Auditing Journal, 21*(5), 476-496.

Al-Tuwaijri, Head of the Saudi CMA,(2010) New Mechanisms to Attract Foreign Investment to the Saudi Capital Market, New York Stock Exchange hosts the “Day of Saudi Arabia's Capital Market”, (2010), Headquarters “Goldman Sachs”, retrieve from: (www.alriyadh.com/2010/03/24/article509618.html - Saudi Arabia).

Ammer, J., Holland, S. B., Smith, D. C., & Warnock, F. E. (2006). *Look At Me Now: What Attracts US Shareholders?* : National Bureau Of Economic Research.

Anderson, C. W., Jandik, T., & Makhija, A. K. (2001). Determinants Of Foreign Ownership In Newly Privatized Companies In Transition Economies. *Financial Review, 36*(2), 161-176.

Ararat, M., & Ugur, M. (2003). Corporate Governance In Turkey: An Overview And Some Policy Recommendations. *Corporate Governance, 3*(1), 58-75.

Bae, K. H., Wei, K. C., & Lim, C. W. (2003). Corporate Governance And Conditional Skewness In The World's Stock Markets.

Baek, J. S., Kang, J. K., & Suh Park, K. (2004). Corporate Governance And Firm Value: Evidence From The Korean Financial Crisis. *Journal Of Financial Economics, 71*(2), 265-313.

Bartov, E., Gul, F. A., & Tsui, J. S. L. (2000). Discretionary-Accruals Models And Audit Qualifications. *Journal Of Accounting And Economics, 30*(3), 421-452.

Beach, S. L. (2006). Why Emerging Market Equities Belong In A Diversified Investment Portfolio. *The Journal Of Investing, 15*(4), 12-18.

Beasley, M. S. (1996). An Empirical Analysis Of The Relation Between The Board Of Director Composition And Financial Statement Fraud. *Accounting Review*, 443-465.

Bliss, M.A., Muniandy, B. and Majid, A., (2007). CEO Duality, Audit Committee Effectiveness and Audit Risks. *Managerial Auditing Journal, 22* (7):716-728.

Borensztein, E., De Gregorio, J., & Lee, J. W. (1998). How Does Foreign Direct Investment Affect Economic Growth? *Journal Of International Economics, 45*(1), 115-135.

Bradshaw, M. T., Bushee, B. J., & Miller, G. S. (2004). Accounting Choice, Home Bias, And US Investment In Non-US Firms. *Journal Of Accounting Research, 42*(5), 795-841.

Brennan, M. J., & Cao, H. H. (1997). International Portfolio Investment Flows. *Journal Of Finance*, 1851-1880.

Brickley, J. A., Coles, J. L., & Jarrell, G. (1997). Leadership Structure: Separating The CEO And Chairman Of The Board. *Journal Of Corporate Finance, 3*(3), 189-220.

Bull, I., & Sharp, F. C. (1989). Advising Clients On Treadway Audit Committee Recommendations. *Journal Of Accountancy, 167*(2), 46-52.

Bushman, R. M., & Smith, A. J. (2001). Financial Accounting Information And Corporate Governance. *Journal Of Accounting And Economics, 32*(1), 237-333.

Byrd, J. W., & Hickman, K. A. (1992). Do Outside Directors Monitor Managers? Evidence From Tender Offer Bids. *Journal Of Financial Economics, 32*(2), 195-221.

Cadbury, A., Butler, I., Butler, J., Charkham, J., Collum, H., Dearing, R., Et Al. (1992). Report Of The Committee On Financial Aspects Of Corporate Governance, December 1: London: Gee Publishing Ltd. Available At Http://Www. Worldbank. Org/Html/Fpd/Privatesector/Cg/Docs/Cadbury. Pdf.

Camfferman, K., & Cooke, T. E. (2002). An Analysis Of Disclosure In The Annual Reports Of UK And Dutch Companies. *Journal Of International Accounting Research, 1*(1), 3-30.

Carcello, J., Hollingsworth, C., Klein, A., & Neal, T. (2006). Audit Committee Financial Expertise, Competing Corporate Governance Mechanisms, And Earnings Management.

Chakrabarti, R., Megginson, W., & Yadav, P. K. (2008). Corporate Governance In India. *Journal Of Applied Corporate Finance, 20*(1), 59-72.

Chambers, A.D., (2005). 'Audit Committees: Practice, Rules and Enforcement in the U.K. and China'. Corporate Governance: *An International Review, 13* (1):92-100.

Chan, K., Covrig, V., & Ng, L. (2005). What Determines The Domestic Bias And Foreign Bias? Evidence From Mutual Fund Equity Allocations Worldwide. *The Journal Of Finance, 60*(3), 1495-1534.

Choe, H., Kho, B. C., & Stulz, R. M. (2004). *Do Domestic Investors Have An Edge? The Trading Experience Of Foreign Investors In Korea*: National Bureau Of Economic Research.

Claessens, S., Djankov, S., Fan, J. P. H., & Lang, L. H. P. (2002). Disentangling The Incentive And Entrenchment Effects Of Large Shareholdings. *The Journal Of Finance, 57*(6), 2741-2771.

Claessens, S., Djankov, S., & Lang, L. H. P. (2000). The Separation Of Ownership And Control In East Asian Corporations. *Journal Of Financial Economics, 58*(1), 81-112.

Cotter, J. F., Shivdasani, A., & Zenner, M. (1997). Do Independent Directors Enhance Target Shareholder Wealth During Tender Offers? *Journal Of Financial Economics, 43*(2), 195-218.

Covrig, V., Lau, S. T., & Ng, L. (2006). Do Domestic And Foreign Fund Managers Have Similar Preferences For Stock Characteristics? A Cross-Country Analysis. *Journal Of International Business Studies, 37*(3), 407-429.

Craven, B., & Marston, C. (1999). Financial Reporting On The Internet By Leading UK Companies. *European Accounting Review, 8*(2), 321-333.

Dahlquist, M., Pinkowitz, L., Stulz, R. M., & Williamson, R. (2003). Corporate Governance And The Home Bias. *Journal Of Financial And Quantitative Analysis, 38*(01), 87-110.

Dahlquist, M., & Robertsson, G. (2001). Direct Foreign Ownership, Institutional Investors, And Firm Characteristics. *Journal Of Financial Economics, 59*(3), 413-440.

Daily, C. M., Dalton, D. R., & Cannella, A. A. (2003). Corporate Governance: Decades Of Dialogue And Data. *Academy Of Management Review, 28*(3), 371-382.

Doidge, C. (2004). US Cross-Listings And The Private Benefits Of Control: Evidence From Dual-Class Firms. *Journal Of Financial Economics, 72*(3), 519-553.

Doidge, C., Andrew Karolyi, G., & Stulz, R. M. (2007). Why Do Countries Matter So Much For Corporate Governance? *Journal Of Financial Economics, 86*(1), 1-39.

Douma, S., George, R., & Kabir, R. (2006). Foreign And Domestic Ownership, Business Groups, And Firm Performance: Evidence From A Large Emerging Market. *Strategic Management Journal, 27*(7), 637-657.

Edison, H. J., & Warnock, F. E. (2003). *US Investors' Emerging Market Equity Portfolios: A Security-Level Analysis*: International Monetary Fund.

Eisenberg, T., Sundgren, S., & Wells, M. T. (1998). Larger Board Size And Decreasing Firm Value In Small Firms. *Journal Of Financial Economics, 48*(1), 35-54.

Fama, E. F. (1980). Agency Problems And The Theory Of The Firm. *The Journal Of Political Economy*, 288-307.

Fama, E. F., & Jensen, M. C. (1983). Separation Of Ownership And Control. *JL & Econ.,* 26, 301.

Ferreira, M. A., & Matos, P. (2008). The Colors Of Investors’ Money: The Role Of Institutional Investors Around The World. *Journal Of Financial Economics, 88*(3), 499-533.

Ferris, S. P., Kim, K. A., & Kitsabunnarat, P. (2003). The Costs (And Benefits?) Of Diversified Business Groups: The Case Of Korean Chaebols. *Journal Of Banking & Finance, 27*(2), 251-273.

Gelos, R. G., & WEI, S. J. I. N. (2005). Transparency And International Portfolio Holdings. *The Journal Of Finance, 60*(6), 2987-3020.

Giannetti, M., & Koskinen, Y. (2005). Investor Protection And The Demand For Equity. *European Corporate Governance Institute (ECGI) Research Paper No. 64/2004*.

Giannetti, M., & Simonov, A. (2006). Which Investors Fear Expropriation? Evidence From Investors' Portfolio Choices. *The Journal Of Finance, 61*(3), 1507-1547.

Gillan, S. L. (2006). Recent Developments In Corporate Governance: An Overview. *Journal Of Corporate Finance, 12*(3), 381-402.

Grossman, S. J., & Hart, O. D. (1988). One Share-One Vote And The Market For Corporate Control. *Journal Of Financial Economics, 20*, 175-202.

Guan, Y., Sheu, D., & Chu, Y. (2007). Ownership Structure, Board Of Directors, And Information Disclosure: Empirical Evidence From Taiwan IC Design Companies. *Journal Of American Academy Of Business, 11*(2), 182-190.

Harabi, N. (2007). State Of Corporate Governance In Arab Countries: An Overview.

Haw, I. M., Hu, B., Hwang, L. S., & Wu, W. (2004). Ultimate Ownership, Income Management, And Legal And Extra-Legal Institutions. *Journal Of Accounting Research, 42*(2), 423-462.

Hermalin, B. E., & Weisbach, M. S. (2001). *Boards Of Directors As An Endogenously Determined Institution: A Survey Of The Economic Literature*: National Bureau Of Economic Research.

Jensen, M. C., & Meckling, W. H. (1976). Theory Of The Firm: Managerial Behavior, Agency Costs And Ownership Structure. *Journal Of Financial Economics, 3*(4), 305-360.

Jiang, L., & Kim, J. B. (2004). Foreign Equity Ownership And Information Asymmetry: Evidence From Japan. *Journal Of International Financial Management & Accounting, 15*(3), 185-211.

Johnson, S., Boone, P., Breach, A., & Friedman, E. (1999). Corporate Governance In The Asian Financial Crisis. *Journal Of Financial Economics, 58*(1), 141-186.

Kalbers, L. P., & Fogarty, T. J. (1993). Audit Committee Effectiveness: An Empirical Investigation Of The Contribution Of Power. *Auditing, 12*, 24-24.

Kalcheva, I., & Lins, K. V. (2007). International Evidence On Cash Holdings And Expected Managerial Agency Problems. *Review Of Financial Studies, 20*(4), 1087-1112.

Kang, J. K., & Stulz, R. (1997). Why Is There A Home Bias? An Analysis Of Foreign Portfolio Equity Ownership In Japan. *Journal Of Financial Economics, 46*(1), 3-28.

Karamanou, I., & Vafeas, N. (2005). The Association Between Corporate Boards, Audit Committees, And Management Earnings Forecasts: An Empirical Analysis. *Journal Of Accounting Research, 43*(3), 453-486.

Kho, B. C., Stulz, R. M., & Warnock, F. E. (2006). *Financial Globalization, Governance, And The Evolution Of The Home Bias*: National Bureau Of Economic Research.

Kim, I. J., Eppler-Kim, J., Kim, W. S., & Byun, S. J. (2010). Foreign Investors And Corporate Governance In Korea. *Pacific-Basin Finance Journal, 18*(4), 390-402.

Kim, W., Lim, Y., & Sung, T. (2007). Group Control Motive As A Determinant Of Ownership Structure In Business Conglomerates:: Evidence From Korea's Chaebols. *Pacific-Basin Finance Journal, 15*(3), 213-252.

Kimberly, E. (2002). *Foreign Portfolio And Direct Investment*.

King, M. E., & Governance, K. C. O. C. (2002). *King Report On Corporate Governance For South Africa 2002: Executive Summary*: Institute Of Directors In Southern Africa.

King and Spalding, Client Art, Middle East and Islamic Finance Practice Group, June 20, 2011. Retrieve to; http://www.google.com.my/url?sa=t&rct=j&q=&esrc=s&source=web&cd=1&ved=0CFMQFjAA&url=http%3A%2F%2Fwww.kslaw.com%2Fimageserver%2FKSPublic%2Flibrary%2Fpublication%2Fca062011.pdf&ei=SOq3T8LnAor3rQeNhZTIBw&usg=AFQjCNGg_q5zaoAvHErmVieEUjdJca5iqQ&sig2=pafoVFqtHS_fDwfeQauamQ

Klapper, L. F., & Love, I. (2004). Corporate Governance, Investor Protection, And Performance In Emerging Markets. *Journal Of Corporate Finance, 10*(5), 703-728.

Klein, A. (1998). Firm Performance And Board Committee Structure 1. *The Journal Of Law And Economics, 41*(1), 275-304.

Klein, A. (2002). Audit Committee, Board Of Director Characteristics, And Earnings Management. *Journal Of Accounting And Economics, 33*(3), 375-400.

Kyereboah-Coleman, A., & Biekpe, N. (2006). The Relationship Between Board Size Board Composition, Ceo Duality, And Firm Performance: Experience From Ghana. *Corporate Ownership And Control, 4*(2), 114-122.

La Porta, R., Lopez-De-Silanes, F., Shleifer, A., & Vishny, R. W. (1997). Legal Determinants Of External Finance. *Journal Of Finance*, 1131-1150.

Lane, P. and G. Milesi-Ferretti(2008). International Investment Patterns. *The Review of Economics and Statistics*, 90, 538-549.

Lang, M. H., Lins, K. V., & Miller, D. P. (2004). Concentrated Control, Analyst Following, And Valuation: Do Analysts Matter Most When Investors Are Protected Least? *Journal Of Accounting Research, 42*(3), 589-623.

Lemmon, M. L., & Lins, K. V. (2003). Ownership Structure, Corporate Governance, And Firm Value: Evidence From The East Asian Financial Crisis. *The Journal Of Finance, 58*(4), 1445-1468.

Leuz, C., Lins, K. V., & Warnock, F. E. (2006). *Do Foreigners Invest Less In Poorly Governed Firms?* : National Bureau Of Economic Research.

Leuz, C., Nanda, D., & Wysocki, P. (2003). Investor Protection And Earnings Management: An International Comparison. *Journal Of Financial Economics, 69*(3), 505-527.

Li, S. (2005). Why A Poor Governance Environment Does Not Deter Foreign Direct Investment: The Case Of China And Its Implications For Investment Protection. *Business Horizons, 48*(4), 297-302.

Lin, C. H., & Shiu, C. Y. (2003). Foreign Ownership In The Taiwan Stock Market--An Empirical Analysis. *Journal Of Multinational Financial Management, 13*(1), 19-41.

Lind, E., Ekkekakis, P., & Vazou, S. (2008). The Affective Impact Of Exercise Intensity That Slightly Exceeds The Preferred Level. *Journal Of Health Psychology, 13*(4), 464-468.

Lins, K. V. (2003). Equity Ownership And Firm Value In Emerging Markets. *Journal Of Financial And Quantitative Analysis, 38*(1), 159-184.

Loderer, C., Neusser, K., & Waelchli, U. (2009). *Firm Age And Survival*: Working Paper, University Of Bern, Switzerland.

La Porta, López De Silanes, F., R., & Shleifer, A. (1999). Corporate Ownership Around The World. *Journal Of Finance, 54*(2), 471-517.

Mallette, P., & Fowler, K. L. (1992). Effects Of Board Composition And Stock Ownership On The Adoption Of" Poison Pills". *Academy Of Management Journal*, 1010-1035.

Mallette, P., & Hogler, R. L. (1995). Board Composition, Stock Ownership And The Exemption Of Directors From Liability. *Journal Of Management, 21*(5), 861-878.

Mangena, M., & Pike, R. (2005). The Effect Of Audit Committee Shareholding, Financial Expertise And Size On Interim Financial Disclosures. *Accounting And Business Research, 35*(4).

Mangena, M., & Tauringana, V. (2007). Disclosure, Corporate Governance And Foreign Share Ownership On The Zimbabwe Stock Exchange. *Journal Of International Financial Management & Accounting, 18*(2), 53-85.

Martin, Philippe, and Helene Rey (2004). Financial Super-Markets: Size Matters for Asset Trade. *Journal of International Economics*, 64:2, 335-361.

Menon, K., & Deahl Williams, J. (1994). The Use Of Audit Committees For Monitoring. *Journal Of Accounting And Public Policy, 13*(2), 121-139.

Millstein, I. M. (1998). Introduction To The Report And Recommendations Of The Blue Ribbon Committee On Improving The Effectiveness Of Corporate Audit Committees. *Bus. Law., 54*, 1057.

Mitton, T. (2002). A Cross-Firm Analysis Of The Impact Of Corporate Governance On The East Asian Financial Crisis. *Journal Of Financial Economics, 64*(2), 215-241.

Nenova, T. (2003). The Value Of Corporate Voting Rights And Control: A Cross-Country Analysis. *Journal Of Financial Economics, 68*(3), 325-351.

Okeahalam, C. C. (2004). Corporate Governance And Disclosure In Africa: Issues And Challenges. *Journal Of Financial Regulation And Compliance, 12*(4), 359-370.

Obstfeld, Marius, and K. Rogoff (2001). The Six Major Puzzles in International Macroeconomics: Is There a Common Cause?. *NBER Macroeconomics Annual*, 15, 339-390.

Park, Y. W., & Shin, H. H. (2004). Board Composition And Earnings Management In Canada. *Journal Of Corporate Finance, 10*(3), 431-457.

Perry, T., & Shivdasani, A. (2005). Do Boards Affect Performance? Evidence From Corporate Restructuring*. *The Journal Of Business, 78*(4), 1403-1432.

Porta, R. L., Lopez-Desilanes, F., Shleifer, A., & Vishny, R. W. (1999). *Investor Protection And Corporate Valuation*: National Bureau Of Economic Research.

Report on the Observance of Standards and Codes (ROSC) in KSA Retrieve to; www.worldbank.org/ifa/rosc_cg_saudia_arabia.pdf

Saudi Arabian Monetary Agency, Samba, (2009), Annual reporting from Saudi Financial Stock retrieves from: (www.samba.com.sa/GblDocs/The_SaudiStock_Market_Arb.pdf)

Shivdasani, A., & Yermack, D. (1999). CEO Involvement In The Selection Of New Board Members: An Empirical Analysis. *The Journal Of Finance, 54*(5), 1829-1853.

Shleifer, A., & Vishny, R. W. (1996). *A Survey Of Corporate Governance*: National Bureau Of Economic Research.

Singh, H., & Harianto, F. (1989). Management-Board Relationships, Takeover Risk, And The Adoption Of Golden Parachutes. *Academy Of Management Journal*, 7-24.

Statistical Data in the Ministry of Finance of Saudi, Estimates of the Balance of Payments.Retrieve from,(http://www.mof.gov.sa/Arabic/DownloadsCenter/Pages/Statistics.asp)

Weisbach, M. S. (1988). Outside Directors And CEO Turnover. *Journal Of Financial Economics, 20*, 431-460.

Wright, D. (1996). Evidence On The Relation Between Corporate Governance Characteristics And The Quality Of Financial Reporting.

Yeh, Y. H., & Woidtke, T. (2005). Commitment Or Entrenchment?: Controlling Shareholders And Board Composition. *Journal Of Banking & Finance, 29*(7), 1857-1885.

Yermack, D. (1996). Higher Market Valuation Of Companies With A Small Board Of Directors. *Journal Of Financial Economics, 40*(2), 185-211.

Appendixes

Table of Company Name

No	Company Name	Type of company
1	Eastern Province Cement Co.	Non-financial
2	The Saudi Investment Bank	Financial
3	The Saudi British Bank	Financial
4	Saudi Mobile Telecommunications Co	Non-financial
5	Etihad Atheeb Telecommunication Company	Non-financial
6	Weqaya Takaful Insurance And Reinsurance Company	Financial
7	Malath Cooperative Insurance And Reinsurance Company	Financial
8	Arab National Bank	Financial
9	BANK ALBILAD	Financial
10	Astra Industrial Group	Non-financial
11	United Wire Factories Company	Non-financial
12	Saudi Steel Pipe Company	Non-financial
13	Savola Group	Non-financial
14	National Industrialization Co	Non-financial
15	Saudi Pharmaceutical Indust.& Med. Appliances Corp.	Non-financial
16	Al-Ahsa Development Co.	Non-financial
17	The National Co. For Glass Industries	Non-financial
18	Alujain Corporation	Non-financial
19	Saudi Arabian Mining Company	Non-financial
20	Almarai Company	Non-financial
21	Yanbu National Petrochemical Company	Non-financial
22	Saudi International Petrochemical Co	Non-financial
23	AL-BABTAIN POWER &TELECOMMUNICATION CO	Non-financial
24	Rabigh Refining And Petrochemical Co	Non-financial
25	Riyad Bank	Financial
26	Yamamah Saudi Cement Co.	Non-financial
27	The Qassim Cement Co	Non-financial
28	Southern Province Cement Co.	Non-financial
29	Yanbu Cement Co.	Non-financial
30	Tabuk Cement Co.	Non-financial
31	Mouwasat Medical Services Company	Non-financial
32	Tihama Advertising & Public Relations Co.	Non-financial
33	Aseer Trading, Tourism & Manufacturing Co.	Non-financial
34	Taiba Holding Co.	Non-financial
35	Al-Baha Investment & Development Co	Financial
36	Arriyadh Development Co.	Non-financial
37	Tourism Enterprise Co.	Non-financial
38	Emaar The Economic City	Non-financial

39	Saudi Printing & Packaging Company	Non-financial
40	Alkhaleej Training And Education Company	Non-financial
41	Qassim Agriculture Co.	Non-financial
42	Tabuk Agriculture Development Co.	Non-financial
43	Ash-Sharqiyah Development Company	Non-financial
44	Al-Jouf Agriculture Development Co. ?????	Non-financial
45	National Metal Manufacturing & Casting Co.	Non-financial
46	Allianz Saudi Fransi Cooperative Insurance Company	Financial
47	SAUDI IAIC COOPERATIVE INSURANCE CO	Financial
48	Arabian Shield Cooperative Insurance Company	Financial
49	Saudi Indian Company For Co- Operative Insurance	Financial
50	National Gypsum Company	Non-financial
51	Al-Ahlia Insurance Company	Financial
52	Jarir Marketing Co	Non-financial
53	Saudi Hotels & Resort Areas Co.	Non-financial
54	Jazan Development Co.	Non-financial
55	Al Sagr Co-Operative Insurance Co	Financial
56	Saudi Ceramic Co.	Non-financial
57	Bupa Arabia For Cooperative Insurance	Financial
58	ACE ARABIA COOPERATIVE INSURANCE COMPANY	Financial
59	AXA Cooperative Insurance Company	Financial
60	BURUJ COOPERATIVE INSURANCE COMPANY	Financial
61	Al Alamiya For Cooperative Insurance Company	Financial
62	Solidarity Saudi Takaful Co	Financial
63	Advanced Petrochemical Company	Non-financial
64	Al Hassan Ghazi Ibrahim Shaker Co.	Non-financial
65	ALABDULLATIF INDUSTRIAL INVESTMENT CO.	Non-financial
66	Mohammad Al Mojil Group Company	Non-financial
67	Alinma Bank	Financial
68	Saudi Cable Company	Non-financial
69	Red Sea Housing Services Company	Non-financial
70	SABB Takaful	Financial
71	Saudi Industrial Investment Group	Non-financial
72	Sanad Insurance & Reinsurance Cooperative Company	Financial
73	Saudi Basic Industries Corp	Non-financial
74	Saudi Automotive Services Co.	Non-financial
75	Saudi Electricity Company	Non-financial
76	Fawaz Abdulaziz Alhokair Company	Non-financial
77	Basic Chemical Industries Co	Non-financial
78	Dar Alarkan Real Estate Development	Non-financial

	Company	
79	Saudi Public Transport Co	Non-financial
80	Saudi Research And Marketing Group	Non-financial

Descriptive Statistics

	N	Minimum	Maximum	Mean	Std. Deviation
FPI	80	.0000	.6490	.094275	.1517616
BSIZE	80	4	13	8.74	1.667
BIND	80	.0000	.9000	.492109	.2166310
AUDSIZE	80	2	6	3.39	.703
AUDIND	80	.0000	1.0000	.442913	.3101369
FIRMSIZE	80	7.24998	11.50185	9.2325227	.87716870
FIRMAGE	80	1	35	18.07	9.020
Valid N (listwise)	80				

Correlations

		FPI	BSIZE	BIND	AUDSIZE	AUDIND	FIRMSIZE	FIRMAGE
FPI	Pearson Correlation	1	.058	.582**	-.146	.652**	-.037	-.261*
	Sig. (2-tailed)		.611	.000	.197	.000	.744	.019
	N	80	80	80	80	80	80	80
BSIZE	Pearson Correlation	.058	1	.206	.066	.118	.187	-.023
	Sig. (2-tailed)	.611		.067	.559	.296	.097	.839
	N	80	80	80	80	80	80	80
BIND	Pearson Correlation	.582**	.206	1	-.143	.636**	.035	-.190
	Sig. (2-tailed)	.000	.067		.206	.000	.757	.092
	N	80	80	80	80	80	80	80
AUDSIZE	Pearson Correlation	-.146	.066	-.143	1	-.149	.258*	.103
	Sig. (2-tailed)	.197	.559	.206		.186	.021	.362
	N	80	80	80	80	80	80	80
AUDIND	Pearson Correlation	.652**	.118	.636**	-.149	1	-.085	-.233*
	Sig. (2-tailed)	.000	.296	.000	.186		.451	.038
	N	80	80	80	80	80	80	80
FIRMSIZE	Pearson Correlation	-.037	.187	.035	.258*	-.085	1	.145
	Sig. (2-tailed)	.744	.097	.757	.021	.451		.201
	N	80	80	80	80	80	80	80
FIRMAGE	Pearson Correlation	-.261*	-.023	-.190	.103	-.233*	.145	1
	Sig. (2-tailed)	.019	.839	.092	.362	.038	.201	
	N	80	80	80	80	80	80	80

**. Correlation is significant at the 0.01 level (2-tailed).
*. Correlation is significant at the 0.05 level (2-tailed).

Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.697a	.486	.444	.1131398

a. Predictors: (Constant), FIRMAGE, BSIZE, AUDSIZE, AUDIND, FIRMSIZE, BIND

ANOVA[b]

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	.885	6	.148	11.524	.000[a]
	Residual	.934	73	.013		
	Total	1.819	79			

a. Predictors: (Constant), FIRMAGE, BSIZE, AUDSIZE, AUDIND, FIRMSIZE, BIND
b. Dependent Variable: FPI

Coefficients[a]

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.	Collinearity Statistics	
		B	Std. Error	Beta			Tolerance	VIF
1	(Constant)	-.041	.147		-.280	.780		
	BSIZE	-.005	.008	-.059	-.677	.500	.922	1.084
	BIND	.197	.078	.281	2.524	.014	.566	1.767
	AUDSIZE	-.006	.019	-.030	-.338	.736	.905	1.105
	AUDIND	.222	.054	.453	4.093	.000	.574	1.743
	FIRMSIZE	.004	.016	.025	.284	.777	.876	1.142
	FIRMAGE	-.002	.001	-.104	-1.193	.237	.924	1.082

a. Dependent Variable: FPI