

**BOARD OF DIRECTORS, AUDIT COMMITTEE  
CHARACTERISTICS AND THE PERFORMANCE OF  
PUBLIC LISTED COMPANIES IN  
SAUDI ARABIA**

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SAUDI ARABIA**

**By**

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**Thesis Submitted to  
Othman Yeop Abdullah Graduate School of Business,  
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in Fulfillment of the Requirements for the Degree of Doctor of Philosophy**

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## ABSTRACT

This study examines the relationship between the internal corporate governance mechanisms related to the board of directors, the audit committee characteristics and the performance of listed companies on Saudi Stock Market (TADAWL) in 2010, excluding financial companies. The theoretical foundation of this relationship was provided by the agency and institutional theory. The data on the relationship between the audit committee and internal audit function was collected through a mail questionnaire. Of the 135 questionnaires distributed, 73 questionnaires, representing a response rate of 54.07 percent, were returned of which 62 (45.93 percent) were usable responses. Other information on firm performance, board of directors and audit committees characteristics was obtained from the annual reports of the respective companies (year-ending 2010). By using the multiple regression analysis, the results show that the effect of internal corporate governance variables on return on assets and Tobin's Q was somewhat different. The results indicate that the proportion of non-executive directors was found to be positively significant to return on assets. However, the board size was found to be negatively significant to Tobin's Q. For audit committee characteristics, the extent of audit committee reviews of IA proposals variable was reported to be positively significant to both measures of firm performance (return on assets and Tobin's Q). In relation to the practical and theoretical contribution, this study provides theoretical validity by suggesting that institutional theory may be more appropriate than agency theory in describing the practices of corporate governance in developing countries such as Saudi Arabia. From a practical perspective, the findings of this study provide feedback to the regulators (e.g. Capital Market Authority) and the companies in Saudi Arabia in a number of ways.

**Keywords:** corporate governance, firm performance, board of directors, audit committee, Saudi Arabia

## ABSTRAK

Kajian ini mengkaji hubungan antara mekanisme tadbir urus dalaman korporat yang berkaitan dengan lembaga pengarah, ciri-ciri jawatankuasa audit dan prestasi syarikat yang disenaraikan di Pasaran Saham Saudi (TADAWL) pada tahun 2010, tidak termasuk syarikat-syarikat kewangan. Asas teori hubungan ini telah disediakan oleh agensi dan teori institusi. Data mengenai hubungan antara jawatankuasa audit dan fungsi audit dalaman telah dikumpulkan melalui soal selidik mel. Daripada 135 soal selidik yang diedarkan, 73 soal selidik, mewakili kadar tindak balas 54,07 peratus, telah dikembalikan di mana 62 (45,93 peratus) adalah jawapan yang boleh digunakan. Maklumat lain mengenai firma papan prestasi, pengarah dan jawatankuasa audit ciri-ciri yang diperolehi daripada laporan tahunan syarikat masing-masing (tahun berakhir 2010). Dengan menggunakan analisis regresi berganda, keputusan menunjukkan bahawa kesan pembolehubah tadbir urus dalaman korporat pada return on assets dan Tobin's Q adalah agak berbeza. Keputusan menunjukkan bahawa perkadaran pengarah bukan eksekutif telah didapati signifikan secara positif kepada return on assets. Walau bagaimanapun, saiz papan didapati negatif yang ketara kepada Tobin's Q. Bagi ciri-ciri jawatankuasa audit, takat ulasan jawatankuasa audit cadangan pembolehubah IA telah dilaporkan signifikan secara positif kepada kedua-dua langkah prestasi firma (return on assets dan Tobin's Q). Dalam hubungan sumbangan praktikal dan teori, kajian ini menyediakan kesahihan teori dengan mencadangkan bahawa teori institusi mungkin lebih sesuai daripada teori agensi untuk menerangkan amalan tadbir urus korporat di negara-negara membangun seperti Arab Saudi. Dari perspektif praktikal, dapatan kajian ini memberi maklum balas kepada pengawal selia (contohnya Pihak Berkuasa Pasaran Modal) dan syarikat-syarikat di Arab Saudi dalam beberapa cara.

**Kata kunci:**tadbir urus korporat, prestasi firma, lembaga pengarah, jawatankuasa audit, Saudi Arabia

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## TABLE OF CONTENTS

TITLE PAGE	i
CERTIFICATION OF THESIS	ii
PERMISSION TO USE	iv
ABSTRACT	v
ABSTRAK	vi
ACKNOWLEDGEMENTS	vii
TABLE OF CONTENTS	viii
LIST OF TABLES	Error! Bookmark not defined.
LIST OF FIGURES	xvi
LIST OF ABBREVIATIONS	xviii
<b>CHAPTER ONE: INTRODUCTION</b>	
<b>1.0 Background of the Study</b>	<b>1</b>
<b>1.1 Motivation for the Current Study</b>	<b>7</b>
<b>1.2 Justification for Doing this Study in Saudi Arabia</b>	<b>9</b>
<b>1.3 Problem Statement</b>	<b>12</b>
<b>1.4 Research Questions</b>	<b>15</b>
<b>1.5 Research Objectives</b>	<b>16</b>
<b>1.6 Significance of the Study</b>	<b>17</b>
<b>1.7 Scope of the Study</b>	<b>19</b>
<b>1.8 Definitions of Terms</b>	<b>20</b>
<b>1.9 Organization of the Study</b>	<b>21</b>

## **CHAPTER TWO: CORPORATE GOVERNANCE IN SAUDI ARABIA**

<b>2.0 Introduction</b>	<b>23</b>
<b>2.1 Background of Saudi Arabia</b>	<b>24</b>
2.1.1 The Politics of Saudi Arabia	24
2.1.2 The Economics of Saudi Arabia	26
2.1.3 The Legal System of Saudi Arabia	30
<b>2.2 Monitoring Bodies in Saudi Arabia</b>	<b>31</b>
2.2.1 The Ministry of Commerce and Industry (MCI)	32
2.2.2 The Capital Market Authority (CMA)	32
2.2.3 The Saudi Stock Exchange (Tadawul)	34
2.2.4 The Saudi Organization for Certified Public Accountants (SOCPA)	37
<b>2.3 Regulations and Laws in Saudi Arabia</b>	<b>37</b>
2.3.1 Company Law (1965) and Company Structure	38
2.3.2 Accounting and Auditing Standards	38
2.3.3 Shareholders' Rights	40
2.3.4 The Company's Internal Control	40
2.3.5 The Corporate Governance Code	41
2.3.5.1 Board of Directors	43
2.3.5.2 Board Committees	44
<b>2.4 Previous Research on Corporate Governance in Saudi Arabia</b>	<b>53</b>
<b>2.5 Chapter Summary</b>	<b>57</b>

## **CHAPTER THREE: LITERATURE REVIEW**

<b>3.0 Introduction</b>	<b>58</b>
<b>3.1 Underpinning Theories</b>	<b>58</b>
3.1.1 Agency Theory	58
3.1.2 Institutional Theory	60
<b>3.2 Literature Review on Firm Performance</b>	<b>64</b>



3.2.1 Accounting Performance Measurement	66
3.2.2 Market Performance Measurement	69
<b>3.3 Literature Review on Internal Corporate Governance</b>	<b>70</b>
3.3.1 Board of Directors	73
3.3.1.1 Board Composition	74
3.3.1.2 CEO Duality	79
3.3.1.3 Board Size	83
3.3.1.4 Chairman of Directors Shareholdings	86
3.3.2 Audit Committee	90
3.3.2.1 Audit Committee Independence	92
3.3.2.2 Audit Committee Meetings	96
3.3.2.3 Audit Committee Shareholdings	98
3.3.2.4 Audit Committee's Relationship with Internal Auditors	99
<b>3.4 Theoretical Framework</b>	<b>108</b>
<b>3.5 Hypotheses Development</b>	<b>113</b>
3.5.1 Board of Directors Characteristics	113
3.5.1.1 Board Composition	113
3.5.1.2 CEO Duality	116
3.5.1.3 Board Size	117
3.5.1.4 Chairman of Directors' Shareholdings	119
3.5.2 Audit Committee characteristics	121
3.5.2.1 Audit Committee Independence	122
3.5.2.2 Audit Committee Meetings	123
3.5.2.3 Audit Committee Shareholdings	124
3.5.2.4 Frequency of Meetings between AC and CAE	126
3.5.2.5 The Extent of AC Reviews of the Internal Auditor's (IA) Proposals	127
3.5.2.6 The Extent of AC Reviews of the Results of the IA Activities	129
<b>3.6 Chapter Summary</b>	<b>131</b>
<b>CHAPTER FOUR: RESEARCH METHODOLOGY</b>	
<b>4.0 Introduction</b>	<b>139</b>
<b>4.1 Research Design</b>	<b>139</b>
<b>4.2 Pre-Testing</b>	<b>140</b>

<b>4. 3 Sample and Data Collection</b>	<b>141</b>
4. 3.1 Sample	141
4. 3.2 Data Collection	141
<b>4. 4 Unit of Analysis</b>	<b>142</b>
<b>4.5 Research Instrument</b>	<b>142</b>
<b>4.6 Operational definition and Measurement of the Variables</b>	<b>143</b>
4. 6.1 Dependent Variables	143
4.6.2 Independent Variables	144
4. 6.2.1 Board Composition	144
4.6.2.2 CEO Duality	144
4.6.2.3 Board Size	144
4.6.2.4 Chairman of Directors' Shareholdings	145
4.6.2.5 Audit Committee Independence	145
4.6.2.6 Audit Committee Meetings	145
4.6.2.7 Audit Committees' Shareholdings	146
4.6.2.8 Audit Committee Meeting with the Chief Internal Auditor	146
4.6.2.9 Audit Committee Reviews of IA proposals	146
4.6.2.10 Audit Committee Reviews of the Result of IA Activities	146
4.6.3 Control Variables	147
4.6.3.1 Firm Size	147
4.6.3.2 Leverage	148
<b>4.7 Method of Data Analysis</b>	<b>152</b>
<b>4.7.1 Descriptive Analysis</b>	<b>152</b>
<b>4.7.2 Inferential Analysis</b>	<b>152</b>
<b>4.8 Model Used</b>	<b>154</b>
<b>4.9 Chapter Summary</b>	<b>155</b>
<b>CHAPTER FIVE: ANALYSIS AND FINDINGS</b>	
<b>5.0 Introduction</b>	<b>157</b>
<b>5.1 Responses</b>	<b>157</b>

<b>5.2 Company Profile and Descriptive Statistics</b>	<b>159</b>
<b>5.3 Correlation Analysis</b>	<b>164</b>
<b>5.4 Regression Analysis</b>	<b>168</b>
5.4.1 Preparing Data for Multiple Linear Regression Analysis	168
5.4.1.1 Outlier Detecting	169
5.4.1.2 Checking the Multicollinearity	170
5.4.1.3 Testing the Normality of the Error Terms	172
5.4.1.4 Testing the Linearity, Homoscedasticity and the Independence of Errors	175
5.4.2 Evaluation of the Models	176
5.4.2.1 Model 1 (Dependent Variable = ROA)	176
5.4.2.2 Model 2 (Dependent Variable= TQ)	181
<b>5.5 Hypotheses Testing</b>	<b>184</b>
5.5.1 Relationship between Board of Directors, AC Characteristics and ROA	184
5.5.2 Relationship between Board of Directors, AC Characteristics and TQ	185
5.5.3 Summary of Hypotheses Testing: ICG and Firm Performance	187
<b>5.6 Further Analyses</b>	<b>190</b>
5.6.1 Board of Directors and Audit Committee Characteristics	190
5.6.1.1 Board of Directors Characteristics	190
5.6.1.2 Audit Committee Characteristics	192
5.6.2 Sensitivity of Proxy for Audit Committee Meetings (ACMEET)	194
5.6.3 Sensitivity of Proxy for CEO Duality (DUAL)	195
5.6.4 Sensitivity for Using the Control Variables As Moderators	196
5.6.4.1 The Moderating Effect of the Firm Size on the Relationship between ICG Mechanisms and Firm Performance (ROA)	197
5.6.4.2 The Moderating Effect of the Firm Size on the Relationship between ICG Mechanisms and Firm Performance (TQ)	202
5.6.4.3 The Moderating Effect of the Debt on the Relationships between ICG Mechanisms and Firm Performance (ROA)	211
5.6.4.4 The Moderating Effect of the Debt on the Relationships between ICG Mechanisms and Firm Performance (TQ)	217
<b>5.7 Chapter Summary</b>	<b>221</b>

<b>CHAPTER SIX: DISCUSSION AND CONCLUSION</b>	
<b>6.0 Introduction</b>	<b>223</b>
<b>6.1 Summary of the Study</b>	<b>223</b>
<b>6.2 Discussion of Hypotheses</b>	<b>229</b>
6.2.1 Discussion of First Model (Results Based on Accounting Measure)	229
6.2.1.1 Board of Directors' Characteristics	230
6.2.1.2 Audit Committee Characteristics	234
6.2.2 Discussion of Second Model (Results Based on Marketing Measure)	238
6.2.2.1 Board of Directors' Characteristics	239
6.2.2.2 Audit Committee Characteristics	242
<b>6.3 Implications of the Study</b>	<b>245</b>
6.3.1 Implications to Theory	245
6.3.2 Implications to Practice	249
<b>6.4 Limitations of the Study and Suggestions for Future Research</b>	<b>250</b>
<b>6.5 Conclusion of the Study</b>	<b>253</b>
<b>REFERENCES</b>	<b>256</b>
<b>APPENDICES</b>	<b>286</b>

## LIST OF TABLES

<b>Table</b>	<b>Page</b>
2.1 Emerging Markets	29
2.2 Share Market Indicators for last 10 years	37
3.1 Summary of Previous Research on Board of Directors, Audit Committee and Firm Performance	132
4.1 Summary of Variables Measurement	151
5.1 Response Rate	159
5.2 Frequency of the Companies according to the Duality Variable	160
5.3 Descriptive Statistics of Continuous Variables	164
5.4 Results of Pearson Correlation Analysis	167
5.5 Multicollinearity Test	171
5.6 Normality Test of the Residuals	175
5.7 Regression Results of Model 1 (Dependent = ROA)	180
5.8 Regression Results of Model 2 (Dependent = TQ)	183
5.9 Summary of the Hypotheses Related to ROA	185
5.10 Summary of the Hypotheses Related to TQ	187
5.11 Summary of the Hypotheses Testing Results	189
5.12 Regression Results between Board Variables and Firm Performance (ROA and TQ)	192
5.13 Regression Results between AC Variables and Firm Performance (ROA and TQ)	194
5.14 Regression Results between ACMEET (Alternative Measure) and Firm Performance (ROA and TQ)	195

5.15	Regression Results between CEO Duality (Alternative Measure) and Firm Performance (ROA and TQ)	196
5.16	The Moderating Effect of FSIZE on the Detailed Model	199
5.17	The Moderating Effect of FSIZE on the Detailed Model	204
5.18	The Moderating Effect of DEBT on the Detailed Model	213
5.19	The Moderating Effect of FSIZE on the Detailed Model	219

## LIST OF FIGURES

Figure		Page
2.1	Outputs of OPEC Countries in Oct 2004	27
2.2	The Foreign Direct Investment Inflows between 1990 and 2011	28
3.1	Research Framework	112
5.1	Histogram of the Regression Residuals	173
5.2	Testing Normality using Normal Probability Plot	173
5.3	Testing Normality using Q-Q Plot	174
5.4	Scatterplot of the Residuals	175
5.5	The Moderating Effect of FSIZE on DUAL - ROA Relationship	201
5.6	The Moderating Effect of FSIZE on BSIZE - ROA Relationship	202
5.7	The Moderating Effect of FSIZE on BSIZE -TQ Relationship	206
5.8	The Moderating Effect of FSIZE on COWN -TQ Relationship	206
5.9	The Moderating Effect of FSIZE on ACREV1-TQ Relationship	207
5.10	The Moderating Effect of FSIZE on BOCOM(NEDs) –TQRelationship	208
5.11	The Moderating Effect of FSIZE on DULT –TQ Relationship	208
5.12	The Moderating Effect of FSIZE on ACIND –TQ Relationship	209
5.13	The Moderating Effect of FSIZE on ACMEET–TQ Relationship	209
5.14	The Moderating Effect of FSIZE on ACOWN–TQ Relationship	210
5.15	The Moderating Effect of FSIZE on ACIAM –TQ Relationship	210
5.16	The Moderating Effect of FSIZE on ACREV2 –TQ Relationship	211
5.17	The Moderating Effect of DEBT on COWN –ROA Relationship	214

5.18	The Moderating Effect of DEBT on ACIND – ROA Relationship	215
5.19	The Moderating Effect of DEBT on ACIAM – ROA Relationship	215
5.20	The Moderating Effect of DEBT on ACREV2 – ROA Relationship	216
5.21	The Moderating Effect of DEBT on BSIZE– ROARelationship	216
5.22	The Moderating Effect of DEBT on BOCOM (NEDs) – TQ Relationship	220
5.23	The Moderating Effect of DEBT on DULT–TQ Relationship	221



## **LIST OF ABBREVIATIONS**

AC	:	Audit committee
ACIAM	:	Audit committee meeting with the chief internal auditor.
ACIND	:	Audit committee independence.
ACMEET	:	Audit committee meeting.
ACOWN	:	Shareholdings held by audit committee
ACREV1	:	Audit committee reviews of internal auditor programmes and plans.
ACREV2	:	Audit committee reviews of the result of internal auditor activities
BODCOM	:	Board composition
BOWN	:	Shareholdings held by directors.
BSIZE	:	Board size
CEO	:	Chief Executive Officer
CG	:	Corporate Governance
COWN	:	Shareholdings held by Chairman
DUAL	:	Role duality
EPS	:	Earnings per share
IA	:	Internal auditor
ICG	:	Internal Corporate Governance
IIA	:	Institute of Internal Auditors
NASD	:	National Association of Securities Dealers

NEDs	:	Non-executive directors
NYSE	:	New York Stock Exchange
ROA	:	Return on Assets
SEC	:	Securities and Exchange Commission
SOCPA	:	Saudi Organization of Certified Public Accountants
SOX	:	Sarbanes-Oxley Act
SSM	:	Saudi Stock Market
TQ	:	Tobin's Q

## LIST OF APPENDICES

Appendix		Page
Appendix A	Saudi Corporate Governance Code	287
Appendix B	Questionnaire in English	307
Appendix C	Questionnaire in Arabic	311

# CHAPTER ONE

## INTRODUCTION

### 1.0 Background of the Study

Corporate scandals, such as Enron (2001), Global Crossing (2002), Tyco (2002), and Worldcom (2002), have shaken investor confidence and made it difficult for companies to raise equity from the stock market (Agrawal, 2005). Zubaidah, Nurmala, & Kamaruzaman (2009) believed that the board of directors and its committees do not have good supervision of the management. For example, Enron manipulated its financial statements through off-balance sheet financing. The board was unable to disclose the distorted statements because of the lack of board independence from senior executives (Deakin & Konzelman, 2004). Moreover, WorldCom materially overstated its earnings and finally filed for bankruptcy. The investigation showed that the audit committee failed to effectively oversee the managers' duties (Weiss, 2005). Consequently, these well-publicized corporate scandals, together with the Asian financial crisis in 1997, have highlighted the importance of good corporate governance practices for the long-term survival of companies (Mokhtar *et al.*, 2009).

Regulators around the world are increasingly looking to set standards or codes of best practice for corporate governance to attract more capital or foreign investment to the country (Agrawal, 2005). For example, following the Sarbanes-Oxley Act (SOX, 2002), the New York Stock Exchange (NYSE) and National Association of Corporate Directors (NASD) proposed a new corporate governance listing-standard, which was approved by

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