CORPORATE GOVERNANCE AND FIRM PERFORMANCE: A STUDY OF PUBLIC LISTED COMPANIES IN THE KINGDOM OF SAUDI ARABIA

ABDULLAH MOHAMMED ALZAHHRANI

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OF SAUDI ARABIA

By

ABDULLAH MOHAMMED ALZAHRANI

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ABSTRACT

This thesis examines the relationship between CG mechanisms and firm performance among firms in the Saudi Stock Exchange (Tadawul) for the periods 2007-2011. Two models have been developed using the framework of agency theory, stewardship theory, and resource dependence theory to test this study’s hypotheses. Model 1 comprises three categories of determinants. The first category is board of directors’ characteristics: board Royal family members, board size, independence, board meetings, board financial knowledge, CEO duality, and board multiple directorships. The second category of determinants is audit committee characteristics: audit committee outside financial expertise, multiple directorships, size, independence, meetings, and financial expertise. The third category is ownership structure: Royal family, non-Royal family, government, and domestic corporate ownership. Model 2, including ownership structure, comprises board of directors’ effectiveness score and audit committee effectiveness score. This study utilizes the Weighted Least Squares (WLS) models. The final sample comprises 573 observations. The results showed that Royal family members, board size, and CEO duality are positively associated with firm performance. In contrast, board meetings, board financial knowledge, and board multiple directorship are negatively associated with firm performance, whereas board independence has no association. Audit committee characteristics, outside financial expertise, size, independence, and meetings are negatively associated with firm performance. In contrast, financial expertise is positively associated with firm performance, whereas multiple directorships have no relationship. For both models, ownership structure—Royal family, non-Royal family, government, and domestic corporations—is positively associated with firm performance. Board of directors’ effectiveness score and audit committee effectiveness score are positively associated with firm performance. It should be noted that the findings established in this study could be useful to regulators, especially the Ministry of Commerce and Industry (MCI), the Capital Market Authority (CMA), Tadawual, and the Saudi Organization for Certified Public Accounting (SOCPA) to improve CG practices. For companies, this study proposes that they should put more emphasis on enhancing the role and the quality of the board of directors and audit committee members, as they are involved in the decisions that improve firm performance.

Keywords: firm performance, corporate governance, Saudi Arabia
ABSTRAK


Kata kunci: prestasi firma, tadbir urus korporat, Arab Saudi
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CHAPTER ONE

INTRODUCTION

1.1 Background and Motivation of the Study

Firm performance has been under scrutiny, especially after the Asian, Russian Federation, and Brazil financial crisis that started in 1997, and the failing of some companies in the United States such as Enron, Xerox, Worldcom, and Parmalat, and the Saudi Stock Exchange (Tadawul) crash in early 2006. In addition, the separation and conflicts of interest between shareholders and managers in companies may lead to agency problems (Berle & Means, 1932; Fama & Jensen, 1983; Ishak & Napier, 2006; Jensen & Meckling, 1976; Mustapha & Che Ahmad, 2011). Corporate Governance (CG) is one solution to the problems stemming from these crises and to align shareholder and management interests, or to reduce conflicts of interest which will, consequently, result in enhancing firm performance (Al-Abbas, 2008; Al-Hamidy, 2010; Al-Hussain, 2009; Al-Moataz & Basfar, 2010; Al-Twaijry, 2007).

Most empirical studies have documented a positive link between CG mechanisms and CG, even though it is not easy to establish the link between the two (Bhagat, Bolton & Romano, 2008). There is a wide belief that CG best practices could lead to superior firm performance (Young, 2003). Different ideas and theories have surfaced; the most important issue is that a huge amount of empirical research in the firm performance discipline has reported an association between the practice of good CG and firm performance in different contexts in the world. For example, Aguilera and Cuervo-
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