THE MODERATING EFFECT OF GOVERNANCE ON THE RELATIONSHIP BETWEEN INVESTMENT OPPORTUNITIES, LEVERAGE AND OWNERSHIP IDENTITY WITH FIRM PERFORMANCE IN THE UAE

BAKR ALI ALI AL-GAMRH

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By

BAKR ALI ALI AL-GAMRH

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This study evaluates corporate governance practices of listed firms in the UAE and examines the hypothesized influence of investment opportunities, leverage, foreign and institutional ownership on firm performance. Corporate governance strength is also investigated as a moderator between investment opportunities, leverage, foreign, institutional ownership and firm performance. The moderating impact of corporate governance strength is also examined during the global financial crisis. After constructing an index to measure corporate governance strength, the fixed effects regression in panel data was used to analyze the data. The data included 101 firms with a total of 501 firm-year observations that spanned the period 2008 to 2012, of all the firms listed on the Abu Dhabi Stock Exchange and the Dubai Financial Market. The results show a significant influence of investment opportunities, leverage and institutional ownership on firm performance represented by Return on Assets (ROA) and Refined Economic Value Added (REVA). However, the results find no influence of foreign ownership on ROA, and a negative influence on REVA. The governance index shows a dramatic improvement in the corporate governance practices over time. In addition, corporate governance strength is found to significantly moderate the relationship between investment opportunities, leverage, foreign and institutional ownership with ROA, but only moderates the relationship between leverage and REVA. During the crisis, corporate governance strength appears to play a more efficient moderating role. The findings of this study provide some insights to the regulators and other related parties about the status of corporate governance practices in the UAE and show that good corporate governance is indirectly able to improve the performance of firms during different time periods.

**Keywords:** corporate governance, firm performance, the UAE, the financial crisis

Kata kunci: tadbir urus korporat, prestasi firma, UAE, krisis kewangan.
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ADIA  Abu Dhabi Investment Authority
ADX   Abu Dhabi Securities Exchange
AED   Arab Emirates Dirham
DFM   Dubai Financial Market
EVA   Economic Value Added
FCIC  Financial Crisis Inquiry Commission
GCC   Gulf Cooperation Council
GFC   Global Financial Crisis
IFRS  International Financial Reporting Standards
OECD  Organization for Economic Co-operation and Development
OLS   Ordinary Least Square
RBS   Royal Bank of Scotland
ROA   Return on Assets
ROE   Return on Equity
REVA  Refined Economic Value Added
SCA   Securities and Commodities Authority
USD   United State Dollar
UAE   The United Arab Emirates
UK    The United Kingdom
US    The United States of America
WACC  Weighted Average Cost of Capital
CHAPTER ONE

INTRODUCTION

1.1 Background of the Study

The issue of corporate governance has received great attention and has attracted the interest of many researchers and practitioners over the last few decades. This attention to and realization of the importance of corporate governance vary from country to country and from time to time. The financial crises are the most influential events that have brought to light the effectiveness of corporate governance practices. This is due to the failure of several corporations around the globe. Various corporate scandals, such as WorldCom, Vivendi, Adelphi, Swissair and Global Crossing shocked the world following the burst of the internet bubble, as well as the scandals of the more recent global financial crisis, such as Washington Mutual, Bear Stearns and Lehman Brothers.

Most Asian countries faced corporate governance issues after the Asian financial crisis from early 1997 to 1998. Negative records have been reported in the performance of East Asian economies, such as the large depreciation in currency exchange, the decline in stock exchanges and the low cash flows (WorldBank, 1998). The global financial crisis has rekindled interest in corporate governance and various parties are pushing for higher governance standards (Dong & Wen-jia, 2009).

After the economic crises, it was realized that weak corporate governance can have potential macroeconomic, long-term and distributional consequences. Companies are
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