



## THE IMPACT OF CORPORATE GOVERNANCE ON ATTRACTING FOREIGN INVESTMENT IN SAUDI SHAREHOLDING COMPANIES (INDUSTRIAL SECTOR)

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### **Abstract:**

The main objective of this research is to investigate the impact of corporate governance on foreign investment. Also, it aims to check whether there is a relationship between corporate governance on foreign investment. The researcher applied the quantitative approach, using the questionnaire to collect the required data. The participants of the study were financial managers and their representatives in Saudi Arabian shareholding companies. The collected responses were only (60) responses. The Statistical Program for Social Sciences (SPSS) was used for data analysis. The study revealed that corporate governance contributes to a reduction in creative accounting practices and thus increases the confidence of foreign investors. The study found that there is a direct association between the application of Corporate Governance and the attraction of foreign investment to the domestic economy in Saudi Arabia. The study recommended that corporate governance not only sets up a system of institutions that govern the relationship between owners, investors, creditors, and managers but also it would contribute in the creation of a good investment environment that attract foreign investment. The obligation to apply corporate governance' principles is considered one of the essential methods that provide foreign investors with a high level of trust.

**JEL:** G30, G34, O16

**Keywords:** corporate governance, foreign investments, shareholding companies, creative accounting

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## 1. Introduction

Nowadays, the world has changed dramatically and turn into a small blue icon on the mobile screen where businesses manage fast, several studies have shown that foreign investments are connected to the development of the universal trade, which has guided to its distribution and growth in modern years and the appearance of international corporations as well as the access of foreign investment into denationalized government organizations (Abo Saleem, 2014). Foreign investment has a prominent role in the progress of the economy and increases the capital state that influences the temporary and long-standing growth of businesses (Kumari et al., 2017). Many countries have looked forward to fascinating better investment by conceding enterprises and incentives to foreign financiers and reducing the obstacles they may face when creating investment judgments. Foreign financier decision is governed by on the time of the outcomes of this company and also on the list of free cash movements, the honesty, and clarity of the commercial reports of this company beforehand he is participating in it (Huang et al., 2016). The clearness, credibility, and truthfulness of the department's financial reporting and the discussion of its weaknesses related to the presence of an internal control system in the company that checks the economic statements so that the company can stay away from the dangers it can meet due to manipulation and absence of clearness (Alhayali et al., 2015). We find that most corporate objectives are profit-oriented and deliver adequate liquidity to prepare them to meet any future problems and to work to increase the outcomes of the company at all levels of management (Asiri, 2013).

Recently the companies are applying the system to govern their departments; this system is known as Corporate Governance. It is a system has a real influence on the clearness, transparency, and trustworthiness of the company's financial reports. Corporate governance is a method that hasn't got a globally uniform definition nor worldwide precise ideologies whereas it is implemented due to the management's capacity to manage, supervise and observe financial reporting (Talamo, 2011) and it is an instrument for assisting investment decisions and motivating foreign investment within the firms.

The Council of Ministers has entrusted the Council of Economic and Development Affairs with the task of establishing the mechanisms and measures necessary to achieve Saudi Vision 2030. The Council of Economic and Development Affairs has developed a comprehensive governance model aimed at institutionalizing, enhancing its work, facilitating the coordination of efforts among relevant stakeholders and effectively following-up progress. (The Saudi Arabian Vision, 2030).

This study will explain the influence of implementing the corporate governance philosophies in Saudi shareholding companies on fascinating foreign investment and their part in economic growth.

### 1.1 Statement of the Problem

The attraction of foreign investment generates modern jobs, decreasing joblessness, growing the percentage of liquid assets, and challenging among shareholding companies. According to the multiplicity of studies on corporate governance in several Arab and foreign countries such as Iraq, Jordan, and India, and the absence of studies implemented in Saudi Arabia. Therefore, the current study will show the influence of the application of the governance system in the Saudi Arabian shareholding companies on attracting foreign investments and the relationship between the corporate governance and foreign investment.

### 1.2 Research Hypothesis

**H01:** The corporate governance contributes to the reduction of creative accounting practices and their impact on financial reporting.

**H02:** The application of the corporate governance system contributes to the creation of a good investment environment that enhances the confidence of the foreign investor.

**H03:** There is a positive relationship between the application of corporate governance and the increased attraction of foreign investment.

### 1.3 Objectives

This study aims to:

1. Clarify the impact of corporate governance in creating a good investment environment through its impact on the company's financial statements.
2. Clarify the impact of Corporate Governance on attracting Foreign Investments.
3. Identify the relationship between Corporate Governance and Foreign Investments in shareholding companies.

### 1.2 Literature Review

Foreign investment has received much attention by academic researches, in particularly in developing countries. According to Kumari et al. (2017), "*foreign investment is essential in the development of any county because it does not only bring the capital but will also bring technology, managerial skill and human capital that supports companies to improve capital availability and influence the temporary and lasting growth*". In addition to that, foreign investment assists companies to grow their efficiency by developing capital position and supports managerial competence.

Banerji et al. (2016) studies the significance of corporate governance and foreign investment in the globalization. The purpose of this study is to investigate the relationship between corporate governance and foreign investment in India. 100 companies listed on Bombay Stock Exchange were selected based on market capitalization of India during the financial year 2010–2013. The researchers found the corporate governance has a positive influence on market capitalization and foreign investment in national markets.

Hawas et al. (2016) tried to develop a corporate governance index based on a group of programmatic requirements to investigate the impact of governance on investment decisions in companies' non-profit in the United Kingdom from 2005 to 2009 and examine whether this relationship has altered throughout the recent financial disaster. Also, examined the impact of the modification in corporate governance at all levels and changes in whole investments. Through the available data from each financial period, (2005, 2009). The study reveals that, there is a positive relationship between corporate governance and investment decisions. As a result, evidence showing the relationship between corporate governance and investment change was reflected by the financial crisis to the end, suggesting that major contributors believe that the application of corporate governance is essential when a problem happens during a specific financial period.

Hawas et al. (2016) helped to explain the impact of companies' application of the governance system on investment decisions and to increase the trust of corporate and investor shareholders. Accordingly, this study has been chosen and will be applied to Saudi Arabia.

Shahid et al. (2016) conducted a study to investigate the impact of Corporate Governance and macroeconomic variables on foreign investment and apply the econometric regression analysis to look at the results of Corporate Governance, foreign exchange percentage, and GDP growing degree on foreign investment in Pakistan throughout the period from 1984 till 2012. The Corporate Governance affects foreign exchange percentage and GDP growth rate have been founded confidently influencing foreign investment.

Kalbounah (2016) intended to identify the influence of the corporate governance guiding principle on the protection of shareholders rights, meeting the public authority, duties of the board of directors, and revelation and transparency on the quality of accounting information in Jordanian public industrial shareholding companies. The participant of the study consists of 39 industrial sectors companies included in the Amman financial market. Hypotheses were verified using the mono-sample and multi-regression test, and arithmetic averages and the standard deviation as statistical analytical methods.

Kalbounah (2016) showed that companies used the corporate governance have transparency and disclosure in their accounting information and it has an association with corporate governance and the quality of accounting information. Corporate governance has an impact on the financial information. Companies that applied a governance system arrange more reliably and transparently financial statements. Consequently, governance affects the quality of accounting information.

Alhayali et al. (2015) studied the significance of corporate governance in Iraq's financial markets to support the national economy as it is an accurate pointer to the situation and safety market, the study specified that the financial market has a chance to develop with investor trust and this needs transparency and fairness by making safeguards in a contradiction of exploitation and mismanagement this can only be

achieved through the application of the governance system. The study showed the problem of the faintness of the Iraq stock market in the service of laws and rules related to the implementation of the principles of governance and the obligation companies apply it and poor entrance to the exact value of the shares of companies itemized on the Iraq Stock Exchange. The study supposed that there was an ethical relationship between governance and investment decision support and that there was an important relationship between governance and investment decision support. There is a constructive moral relationship between corporate governance and investment decision support (Alhayali et al., 2015).

Bilal et al. (2015) tried to discover the impact of foreign investment on economic growth in Algeria at the period from 1990 till 2010 and to reach the results which clarify the correlation between foreign investment and economic progress, the study used (EC) method which contains the next tests: unit root to check stability, the Johansson test, and the Granger test of causation. The study found that there is relationship between foreign investment and gross domestic product (GDP). Also, there is a long-term relationship between foreign investment and economic growth, added to that, the foreign investment participates marginally to the temporary economic development.

Jarirah et al. (2015) described the impact of corporate governance in reducing creative accounting practices in Jordan's public shareholding industrial companies from two perspectives: the public shareholding industrial companies and external auditors. The study has followed surveys to population and participants of Jordan's public shareholding manufacturing companies and exterior auditors, where the study population was 57 companies; 50 companies were chosen as participants for the study, and this study has applied statistical methods to examine results and test hypotheses. They have realized that corporate application of the governance system participates effectively in the reduction of creative accounting practices and has constructive results on the quality of financial reporting and the efficiency of the control process. The study suggested coordination between interior and exterior auditing to control revelation in financial reporting and danger administration, and to observe the strong point and faintness of auditors outside and work to develop their expertise, and obliged companies to implement the corporate governance system.

Asiri (2013) aimed at determining the extent to which Saudi shareholding companies listed under the Saudi stock market have revealed the government rule delivered by the market authority financial. The study studied corporate disclosure of governance needs for nine components of governance and nine questions connected to the extent of disclosure were developed the degree of these components. The study was grounded on the analytical descriptive method and the implementation of the analysis of the financial reports of the Saudi shareholding companies to the applied side the reports of 95 Saudi shareholding companies published in 2008 have been studied. The researcher has realized that the most Saudi shareholding companies disclose the governance requirements stated in the study but to varying degrees. The study suggests that Saudi shareholding companies will be required to use the governance regulation and the

importance of the Financial Market Authority's follow-up to the governance rules of these companies, and the importance of upgrading self-censorship by the company's departments and employees, which helps in the planning of financial reports in a supplementary transparent, pure and honest manner because Self-censorship exceeds external control. The study suggests that committing the Saudi shareholding companies to apply the rules of governance and the importance of following up the Capital Market Authority to apply the rules of governance in these companies, and the importance of motivating self-censorship in the sections of the company and its employees, which assists in the planning of financial reports more transparent and clear and more secure because self-censorship exceeds external control. This study has been selected to check whether the recommendations of this study were applied in Saudi shareholding companies or not. If governance is applied, is the preparation of financial reports clear and transparent?

Haldar et al. (2011) clarified the aspects influencing foreign investment in India as well as the impact of corporate governance on foreign investment based on annual information concerning governance and foreign investment, the study goes over a major problem in developing countries in general and India in particular, the association between the corporate governance and foreign investments. The researcher reviewed Indian industrial companies have been chosen 500 companies applying corporate governance. The study was able to show that corporate governance is an important variable affecting foreign investment decision and has shown that there is a positive relationship between corporate governance and foreign investment. This study confirmed a relationship between corporate governance and foreign investment based on the data collected after reviewing the Indian economic condition only, making it further hard to take a broad view to other developing countries and requires additional work and power.

## **2. Materials and Methods**

To examine the relationship between corporate governance and attracting the foreign investment in Saudi Shareholding companies (Industrial Sector), the study depends on the quantitative approach, and collecting the data by designing and distributing a questionnaire survey to a simple random sample including top employees in financial departments, including the financial managers. The sample was selected from the population of Saudi industrial listed companies (183). The researcher has able to return a round (60) valid responses.

### **2.1 Data analysis**

To analyze and interpret the data collected and to test the research hypotheses, the researcher uses various statistical techniques including the descriptive and inferential statistical methods. The descriptive statistical methods used to evaluate the impact of application of Corporate Governance on the foreign investment attraction into Saudi

industrial listed companies. In addition to that, Person's Correlation coefficient used to test the research hypotheses.

### 3. Results of Testing the Research Hypotheses

**H01:** The corporate governance contributes to the reduction of creative accounting practices and their impact on financial reporting.

To test the hypothesis, Chi-Square test was run, and the results demonstrated in Table 1 below:

**Table 1:** The association between the application of corporate governance and the reduction of creative accounting practices and their impact on financial reporting

Item No.		Chi-Square	D.F	P-value
4	Corporate governance leads to the realization of the function of disclosure and transparency Better and thus contribute to attracting foreign investment.	22.67**	3	0.00
5	Corporate governance leads to a reduction of manipulation, corruption, and fraud, which enhances the confidence of the foreign investor in the local economy.	71.33**	4	0.00
6	Generates financial statements for companies committed to the application of Governance Principles Trust To the foreign investor.	29.73**	3	0.00

\*\*indicated that Chi-Square test is significant at the (0.01) significant level.

The results of Chi-Square test showed that all values of Chi-Square are statistically significant at the (0.01) significant level. This proved that there is a statistically significant association between the application of Corporate Governance, and the reduction of creative accounting practices, and their impact on financial statement.

Therefore, the positive effect of applying the Corporate Governance in the industrial listed companies will achieve the transparency that would contribute in the financial reporting, which in turn will have a positive effect on attracting foreign investment to the local economy.

**H02:** The application of the corporate governance system contributes to the creation of a good investment environment that enhances the confidence of the foreign investor.

The results of testing the second hypothesis presented in Table 2 below:

**Table 2:** The results of the Association between the application of corporate governance systems and the creation of a good investment environment that attract of foreign investor

Item No.		Chi-Square	D.F	P-value
9	Adherence to governance principles helps to open global markets to Saudi company products.	69.83**	4	0.00
10	The commitment to apply governance principles helps to empower local firms Merger or alliance with foreign companies.	34.93**	3	0.00
11	the obligation to apply the principles of governance adds to local corporations the international attribute.	52.83**	4	0.00
12	The commitment to apply the principles of governance is one of the essential complements of free trade agreements with the countries of the world.	3.067	3	0.38

\*\*indicated that Chi-Square test is significant at the (0.01) significant level.

The results of Chi-Square test in table (2) revealed that most values of Chi-Square are statistically significant at the (0.01) significant level. This proved that there is a statistically significant association between the application of Corporate Governance, and the attraction of foreign investor.

Therefore, the application of Corporate Governance in the Saudi industrial listed companies will create a good investment environment, which is capable to attract the foreign investment into the internal or local economy.

**H03:** There is a positive relationship between the application of corporate governance and the increased attraction of foreign investment.

To test this hypothesis, Chi-Square test was run, and the results displayed as in Table 3 below:

**Table 3:** The results of testing the association between the application of corporate governance and the increased attraction of foreign investment

Item No.		Chi-Square	D.F	P-value
7	The existence of legislation binding on the application of the principles of governance contributes to bringing foreign investments.	36.40**	3	0.00
8	The foreign investor verifies the corporate obligation to apply the principles of governance before bringing his investments to the state	21.60**	3	0.00
13	Applying the principles of governance contributes to attracting and polarizing Foreign investment.	20.40**	3	0.00

\*\*indicated that Chi-Square test is significant at the (0.01) significant level.



The results of running Chi-Square test in the above table revealed that, all Chi-square test values are statistically significant at the (0.01) level. Therefore, there is a significant association between the application of corporate governance and the increased attraction of foreign investment in the country.

Therefore, whenever, the industrial listed companies in Saudi Arabia obligated to apply corporate governance, this will contribute positively in the increased foreign investment into Saudi industrial sector.

## **5. Discussion, Conclusion & Recommendations**

### **5.1 Discussion**

The study found that corporate governance contributes to the reduction of creative accounting practices and their impact on the preparation of reports financial. This result was supported by Jarirah, et al. (2015) who found that corporate application of the governance system contributes significantly to the reduction of creative accounting practices and has a positive impact on the quality of financial reporting and the effectiveness of the control process.

Furthermore, Kalbounah (2016) who stated that the application of corporate governance contributed to the credibility and integrity of the preparation of corporate financial statements. Moreover, the current study showed that the commitment to implementing corporate governance reduces corruption and fraud, which enhances the confidence of foreign investors in the local economy and contributes positively to attracting foreign investment by opening the global market to the products of Saudi companies in addition to attracting foreign investment. This result has been proven and supported by Kumari et al. (2017) study, which shown that corporate governance contributes to the introduction of technologies to the country by increasing the confidence of foreign investors and attracting foreign investments. In addition to that Banerji et al. (2016) proved that corporate governance and foreign investment are very important phenomena in globalization at present.

Furthermore, Alhayali et al. (2015) have explained the application of the governance system in the Iraqi financial market has increased the transparency of the financial statements, thereby increasing the confidence of foreign investors in the market. Finally, to conclude the finding, the study revealed that there is a statistically significant relationship between applying corporate governance and attracting foreign investment in the country. This means that the more listed Saudi industrial companies are obliged to apply corporate governance, the more positive it will be to increase foreign investment in the Saudi industrial sector, as evidenced in the study.

This finding has been supported by Haldar (2011) who found a correlation between corporate governance and foreign investment based on the data gained after studying the Indian economic situation.

## 5.2 Conclusion

Attracting foreign investment has crucial importance, and benefits for all developed and developing countries. It brings capital to the local economy. Furthermore, it creates job opportunities for the local population, and among the most important thing to the economy is the transferring technology and modern means of production. For Saudi listed companies to attract foreign investment, the application of Corporate Governance is very important, and one of the most significant factors to attract a foreign investor to the domestic economy. The current research investigated the impact of application corporate Governance on the attraction of foreign investment. The results showed that, there a direct association between the application of corporate Governance, and the attraction of foreign investment to the domestic economy in Saudi Arabia. The study revealed that, corporate governance doesn't only set up a system of institutions that govern the relationship between owners, investors, creditors and managers, but also it would contribute in the creation of a good investment environment that attract foreign investment. The obligation to apply corporate governance' principles is considered as one of the essential methods that provide the foreign investor with a high level of trust.

## 5.3 Recommendations

Based on the final findings of the study, the researcher recommended the following: Corporate governance should be applied for companies that obligate to apply its principles. Furthermore, the Saudi industrial listed companies should have to be serious enough to present a high level of obligation to the principles of corporate governance because this will increase the level of inflow of foreign investment in the companies and will get the benefit of bringing modern technological means of production. Finally, several studies should be conducted within large number of participants to ensure more accurate results to be generalized in all Saudi companies.

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