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CORPORATE PERFORMANCE UNDER CORPORATE GOVERNANCE IN THE GCC COUNTRIES

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Abstract

This study is an attempt to explore the relation between the new corporate governance enforcement in the Gulf -GCC- countries and management performance at large. Independent variables within corporate governance cluster have been identified to determine their possible effect on other dependent variables within the cluster of management performance. The study provides empirical support of the added value of corporate governance at both the national as well as the regional level.

A deductive research method is adopted to better identify the problem and reach some conclusions. It includes a recognized statistical testing as well as a basic arithmetic model to build up some relationships which may lead to some sort of correlations that assist in interpreting and determining perceptions toward the issue. Results have shown noticeable impact of the same across the tested data and calls for more rigid enforcement of legislative governance among GCC firms.

Keywords: *corporate governance - management performance - Board Composition - Governance Measurement - Governance Index.*

The Rise of Global Corporate Governance

It has always believed that corporate governance has risen worldwide due to the late financial scandal in the west. However, the theme has a wider scope and a multi-faceted subject. One of which, is to ensure the accountability of certain individuals in an organization through mechanisms that try to reduce or eliminate agency problems (Robins, 2006). Actually, corporate governance momentum has been adopted as some sort of logo or supreme cause since 2001 due to the collapses of high profile

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companies in the industrial world such as Enron and WorldCom. The US Government had to interfere in regulating businesses and restoring confidence in the community by passing the Sarbanes-Oxley Act.

Corporate governance is not a new concept in the world of business management. It goes back to the 19th century when the famous agency theory was introduced on the background of public corporations and the need to separate their functions from those of the owners, as well as to maintain some method of control over management performance (AlWazer, 2007: p.2).

Regardless to the various definitions of corporate governance, it encompasses the mechanism of which a business organized in a limited liability corporate form is to be controlled (Gregory and Simmelkjaer, 2002, p.8). Others consider it as laws, regulations, and voluntary practices which result in best performance by humans and maximizing the net worth of the entity by securing and safeguarding its interests (Bauer, Guenster and Otten, 2004; Bianco, Ghosh and Sirmans, 2007; Brown and Caylor, 2006; Cremers and Nair, 2005; Drobetz, Schillhofer and Zimmermann, 2004; Ghosh and Sirmans, 2003; Han, 2006; Hartzell and Kallberg, 2008; Shin and Stulz, 2000). Different theoretical perspectives on corporate governance have been overviewed and further elaborated by many scholars within various domains (Dignam and Lowry, 2006). This all comes from the ground of corporate governance and effective components such as transparency and enforceability of the rights and prerogatives of all shareholders and directors of the business entity. Therefore, corporate governance is regarded as an internal system of policies and procedures which serve the requirements of shareholders and other stakeholders of the business entity in general (O'Donovan, 2006; 2003). All in all, the definition basically refers to all sorts of relationship, policies, and strategies among shareholders, stakeholders, creditors, board of directors, and government agencies aiming at efficiency in corporate performance (OECD, 2004).

International Researchers are arguing that corporate governance is static and that cross-sectional differences rather than time-series changes explain the effect of corporate governance on performance, but the short time span does not allow test how severe the endogeneity issue actually is. Countries all over the world converge toward governance standards which will likely broaden the scope of future corporate governance research. A parametric index will enable us to focus on all measures of corporate governance, but not on ownership concentration. As institutional ownership is increasing and the role of shareholders is becoming more prominent, future research may incorporate this external governance mechanism in the analysis (Bauer et al, 2009).

Despite the fact that corporate governance has given rise to number of claims and other legal suits against corporation management for negligence and poor performance (OCED, 2004), but it has many blessings. Corporate governance affects the development and functioning of capital markets and exerts a strong influence on resource allocation. In an era of increasing capital mobility and globalisation, it has also become an important framework condition affecting the industrial competitiveness and economies of developing countries (Maher and Andersson, 1999).

Other has addressed some of the underlying factors that promote efficient corporate governance, and examines some of the strengths, weaknesses and economic implications associated with various corporate governance systems. Through a survey of empirical evidence on the link between corporate governance, firm performance and economic growth, differences have been found between countries' corporate governance systems due to the difference in the ownership and control of firms that exist across countries. There are tradeoffs between ownership concentration and voting power concentration (Berglof, 1997; Maher and Andersson, 1999).

The Present Status of Corporate Governance in the Gulf Co-Operation Council Countries (GCC)

Indeed, a 2008 survey of Middle Eastern and North African corporate governance practices by the Dubai-based Hawkamah corporate governance institute and the Washington-based International Finance Corporation found that not a single publicly listed company in the region followed best practice, and only 3% of surveyed firms followed good practice. Most firms said they did not have better practices because it was not required. This Lack of transparency would certainly make it more difficult to make sound investment decisions. Accordingly to Hawkamah survey in 2009 (table 1), compliant with corporate governance guidelines is to some extent moderate with 50% of the states are below an average compliance with these guidelines (HCGI, 2009).

Table 1: Comparison of Corporate Governance Framework in the GCC with IIF Guidelines (on Scale of 1-5 with 5 being fully compliant)

| | Bahrain | Kuwait | Oman | Qatar | Saudi Arabia | United Arab Emirates |
|--|---------|--------|------|-------|--------------|----------------------|
| Minority Shareholder Protection | 2.0 | 4.0 | 3.0 | 2.5 | 3.5 | 2.5 |
| Voting Rights | 1.5 | 3.5 | 3.5 | 2.5 | 2.0 | 3.5 |
| Firm Capital Structure | 1.5 | 4.5 | 1.0 | 2.0 | 5.0 | 2.0 |
| Shareholder Meeting/ Other rights | 3.0 | 3.5 | 3.5 | 3.0 | 3.0 | 2.5 |
| Structure and Responsibilities of the Board of Directors | 2.0 | 1.5 | 3.5 | 1.5 | 2.0 | 1.5 |
| Board Structure | 1.0 | 1.5 | 3.5 | 1.5 | 1.0 | 1.0 |
| Disclosure | 4.0 | 3.5 | 5.0 | 1.5 | 4.0 | 3.5 |
| Others | 1.0 | 0.5 | 2.5 | 0.5 | 2.5 | 0.0 |
| Accounting & Auditing Standards | 2.0 | 2.5 | 4.0 | 2.0 | 2.5 | 2.0 |
| Audit Committee | 3.0 | 3.5 | 3.5 | 3.0 | 3.5 | 2.5 |
| Audit Committee | 0.5 | 0.0 | 5.0 | 0.0 | 0.0 | 0.0 |
| Transparency of Ownership & Control | 2.5 | 3.5 | 3.5 | 1.0 | 4.5 | 2.5 |
| Regulatory Environment | 2.0 | 2.0 | 4.5 | 2.5 | 2.5 | 2.0 |
| Overall Assessment | 2.0 | 3.0 | 3.5 | 2.0 | 3.0 | 2.0 |

In part, the traditional lack of awareness of corporate governance issues in the GCC is down to the region's historic isolation from the global economy, large regional banks that were on hand to provide cash for companies, strong economic growth, and undeveloped capital markets. The Gulf's family-owned businesses, which account for some 90% of commerce in the region, often shy away from disclosing details of their business affairs; and in many cases, government-related enterprises, are murky, too. (Watts, 2009). A growing number of regional policy makers and business leaders are seeing that sound corporate governance can be a source of competitive advantage. Equitable treatment of shareholders, well-defined board responsibilities, high standards of integrity and ethics, and full disclosure and transparency can help align management's interests with shareholders' interests. Sound governance practices also help to minimize conflicts of interest, and leave less room for corruption and mismanagement.

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According to a survey of 581 Gulf companies by UAE bank, the national investor, banks and companies in Kuwait and Saudi Arabia have the lowest standards of corporate governance in the GCC. Even though, it was found that two-thirds of companies surveyed had improved their corporate governance practices during the prior year (DIFC, 2009). Corporate governance practices across the GCC are lagging behind global standards in a number of areas. However, there appears to be considerable agreement that a stronger equity culture needs to be fostered and that high priority should be assigned now to programs to enhance corporate governance. We are encouraged by the determination of Hawkamah, the DIFC and national authorities in this area (Dallara, 2009).

Pressure for Corporate Governance in the GCC

The banking sector in the GCC has made a significant contribution, following undertakings by central banks to comply with Basel I and II requirements. Central banks in all six GCC countries have amended their banking regulations to include corporate governance-related requirements such as establishing transparency and disclosure in financial statements, establishment of a board level audit, nomination and compensation committees and improved risk management (Dabdoub, 2009).

In the case of the GCC report, corporate governance frameworks through the lens of professional investors are vital in global markets, with assessments based on the IIF Code of Corporate Governance. From an investor perspective, it is important that there is visible movement in the right direction across the region, which can contribute to building confidence. But hopes are there that the public and the private sectors in the region can

work together in the period ahead to secure improvements in the GCC's overall corporate governance framework (Baker, 2009).

Developments for strict enforcement of corporate governance code of practices in the GCC have been largely driven by four key factors: capital market regulators whom are using the recent price correction in GCC stock markets to 'upgrade' corporate governance frameworks, public pressure to intervene, due to their past encouragement of widespread public participation in IPOs, capital market authorities in the GCC- the Muscat and Abu Dhabi exchanges introduced codes in 2003 and 2006 respectively, while regulators in the UAE, Saudi Arabia, Bahrain, Qatar and Kuwait have draft similar codes in 2007, and finally increased corporate activity by GCC corporations in international markets is contributing to improvements in private sector standards, in-line with international best practice. GCC corporations have conducted USD25.9 billion of acquisitions in the UK, Europe and North America so far this year (Heineman, 2010).

Earnings mitigations on the other hand, has also give rise to banks Corporate governance as it formulated a phenomenon especially in huge capital markets such as the US. Certainly, this will end up in inflating valuations of assets and may result in another financial crisis (Warfield & Cheng, 2005). Similar studies were conducted in developing countries and reached astonishing remarks with respect to the effect of corporate governance to the business continuity that could embrace doubts to the public related to transparency and trust worthy transactions (Shah, et al, 2009; Luohe, et. Al, 2008; Jean, et al., 2004). In fact, it is said that the institutionalization of economic reform and corporate governance around the world is one of the fundamental challenges of promoting democracy and economic stability. A link has also been identified between democracy and economic growth, especially when proper governance mechanisms are prevalent (Doucouliagos and Ulubasoglu, 2008; Rivera-Batiz, 2002; Sekaran, 2006; Wen and Philomena, 2006).

GCC seem eager to liberalize and expand their economies and markets and attract international capital flows. As much as these markets appeal to international investors, the achievement of these ends and the ability to sustain them place regulators under pressure to establish well-governed financial markets. Consequently, a culture of sound corporate governance, where shareholders ensure that they are treated equally, their rights are respected, their best interests are pursued by directors and managers and transparency and disclosure rules are imposed, will gradually emerge among all market participants. Citizens will come to realize that their rights as shareholders in companies are to a large extent equivalent to their rights as nationals in their countries. This is in line with Gompers, Ishii, and Metrick's (2003) description of companies as republics where the rights of shareholders mirror those of citizens in their nations and where the fiduciary duties of boards of directors and managers, respectively, resemble to a great extent those of parliamentary members and ministers. Thus, citizens will learn to adopt an active, rather than a passive, role in their countries. Consequently, an awareness of democratic practices will become prevalent among the communities of the Arab countries. These include the right to elect representatives who are accountable for acting according to the will of the

people and responsible for delegating decisions to ministers and examining the performance of the government.

An environment in which citizens have the power to hold ministers and governmental authorities accountable and to replace them when necessary is regarded as a democracy. In such a setting, citizens would also press to be allowed to express their opinions freely; have access to transparent information on the activities of the authorities, the government and the public institutions; and impose disciplinary actions on corrupt behaviors. In the Gulf Cooperation Council (GCC) countries, improvements at the public level have already started to take effect. According to the World Bank, regulatory quality and control of corruption are two aspects of public governance that have particularly improved. Over the past decade, the two measures respectively increased from averages of 0.44 and 0.11 to averages of 0.54 and 0.69 for the GCC countries (Kaufmann, Kraay and Mastruzzi, 2008).

Recent changes in GCC governance patterns that significantly altered power relations and wealth distribution in global commodity chains addressed by many scholars (Marcia et al, 2008; Illoong et al, 2008; Butzbach & Di Carlo, 2008). It emphasizes the rise of a financial sphere made up of institutional investors and executives of large corporations at the top of GCCs, and discusses the consequences of this for supplier relations and working conditions of women workers at the base of GCCs. Also, it links recent governance debates at the level of the firm to issues of governance of the whole chain, it identifies three distinct normative views (shareholder, stakeholder and institutional) of the ways in which the distribution of social welfare can be improved in GCCs. Beyond the shareholder and stakeholder views, calls are made for strengthening an institutional view of GCC governance (Florence, 2008).

Importance of the Study

The financial crisis has led to tightened liquidity across the world. But in the Gulf, there are signs that intensified competition for capital has heightened interest in corporate governance issues. Earlier 2009 year, the Qatar Financial Markets Authority brought in a corporate governance code for all listed companies, based on the 'comply-or-explain' approach seen in the UK. In the UAE from 2010, all listed companies will be obliged to comply with corporate governance rules; currently, it's voluntary. And in Saudi Arabia, too, capital markets policymakers are making more and more corporate governance regulations compulsory. The Saudi capital market authority has issued a draft code for corporate governance for publicly trading Saudi companies (Almutairi, 2003).

At the same time, groups such as Hawkamah are adding to the momentum. Other examples include the Dubai-based Mudara Institute of Directors, which has launched an initiative to educate company board members about best practices in corporate governance. And last November, the Middle East Investor Relations Society held its inaugural awards ceremony, based on a Thomson Reuters Excel survey of fund managers who invest in the

region. Events such as these raise awareness of corporate governance issues among the region's top brass (MID, 2009).

As policymakers ponder reform, strengthening governance in the banking and financial sector is critical, where financial intermediation in the Gulf is largely bank-based, rather than markets-based, so good corporate governance among financial institutions may help lower systemic risk. Furthermore, reforms should also target family-owned businesses, and enterprises linked to the state (Saidi, 2009).

Despite indications that sound corporate governance practices are taking root in the region, cases similar to that of Damas International also occur in the US, and the UK, where the principles of good corporate governance have been established longer than in the Gulf (Schutzmann, 2010).

Downward corrections in GCC stock markets and increased corporate activity by GCC corporations in Western markets are driving improvements in corporate governance standards (IIF, 2009). IIF report is part of a co-ordinate strategy toward the harmonization of corporate governance standards in the GCC and their alignment with international best practice and to benchmark standards in the region. It is the result of a series of meetings held with senior officials from capital market authorities, central banks and stock exchanges, local fund managers, lawyers, experts, accountants and management consultants involved in corporate governance in the GCC (IIF, 2009, p. 7).

The Hawkamah-IIF survey shows that corporate governance in the GCC is generally at an early stage of development. However, it also notes that real progress is being made as countries amend existing company laws, strengthen accounting frameworks, and introduce corporate governance requirements for companies. Good corporate governance is a key factor in sustaining economic growth and development in the GCC. Policy makers are taking the lead and committing to secure significantly higher standards of corporate governance in the member countries of the GCC (Saidi, 2009).

This article contributes to the existing corporate governance literature in three ways. First, instead of relying on self-constructed governance measures, corporate governance performance indicators were used, which are widely used in practice and includes most of the governance mechanisms that are relevant for investors. This measurement is based on multiple categories and thus represents a much more complete proxy of corporate governance than, for example, the often-used G-Index constructed by Gompers, Ishii and Metrick (abbreviated GIM - 2003). The G-Index is based on the Investor Responsibility Research Center (IRRC) surveys and covers only two categories of corporate governance: investor rights and takeover protection (Bauer et al, 2009).

The use of a governance index has the advantage of capturing the effects of all individual governance mechanisms in one single number (Boehren and Odegaard 2003, Black et al, 2006). To my knowledge, this is the first GCC study that exploits a comprehensive corporate governance measurement.

Second, investigation is also conducted to the governance-performance relation to the enforcement of international accounting standards which have been adopted widely in the region. It is rational to presume that such standards would enhance the governance theme and improve corporate performance as observed in western economies.

The third contribution of the article is that we use a broad set of performance measures and methodologies to estimate the impact of corporate governance on firm performance. This, in turn, will contribute in boosting the added value of these firms in the economic growth and the financial stability of the GCC countries.

Literature Review: Corporate Governance and Performance

A large body of corporate governance literature investigates the relation between corporate governance and performance. Most studies focus on one specific aspect of governance such as ownership structure, board composition or executive compensation, and relate this to performance. In their widely cited paper, GIM (2003) construct a so-called G-Index, in which takeover provisions are used as a proxy for the level of shareholder rights. The creation of an index allows for alternative methodologies, but it should be noted that the G-Index is based on one aspect of corporate governance only (Bauer, 2009).

The quality of corporate governance and corporate efficiency as well as management performance has been a focal point for many studies indicating the justification and level of premium that investors are willing to pay for shares of corporations with high governance. A survey by Mckinsey in 2000 and 2002 on over 200 international investment companies has shown that 80% of them are accepting to pay such premium for this governance (Mckinsey and Company 2002). The findings of this survey include variances in the amount of premium to be paid for corporate governance according to the country under study and the level of transparency in the financial disclosure.

De Nicolò et al (2006) have conducted a two stage study on the evidence of corporate performance and the enforcement of corporate governance. The first stage is an attempt to validate if corporate governance has improved for any reason, while the second stage was to investigate the effect of corporate governance on corporate performance and consequently on productivity and financial stability. The study was basically based on a comparison between the de facto measures and de jure measures in order to measure accomplishment with legislation requirements. Their attempt ended in finding a widespread measurement known the CGO based on the accounting published data and other information for non listed companies in local market in order to reach market discipline status. The premise within this measurement is setting an average parameter that combine three measurements; accounting standards, earning smoothing, and stock price Synchronicity - R2 (see Leuz et al, 2003; Morck et al, 2000). The study resulted in three interesting results; first it concluded that CGO in the selected countries within the period 1994-2003 has shown progress due to improvements in the financial transparency. Second, countries have close CGO's and those shown low measures have taken actions toward

improvements. Finally, improvements in CGO have deep effect on the micro as well as the macro economic indicators of the country.

Corporate governance is embedded in the cultural, legal, and financial frameworks of various countries. These frameworks have given rise to two models of corporate governance: market and control (Lane et al, 2006). The market model of corporate governance is common in countries where capital markets are highly liquid and shareholders are widely dispersed, such as in the United States, the United Kingdom, and Ireland. This model involves a large dispersed class of investors with no prior connections to the companies listed on the public exchanges (Coombes and Watson, 2001). The focus of corporate governance reform in countries employing this model is on board structures and practices that ensure that the board is a distinct entity, capable of objectivity and able to act separately from management (Gregory and Simmelkjaer, 2002). While the control model of corporate governance, commonly found in Asia, Latin America, and much of continental Europe, is prevalent where control rights are not fully separated from ownership and ownership tends to be concentrated. An example of a control model company is Fiat SA, Italy's third most valuable company (LaPorta, Lopex-de-Silanes and Shleifer, 1999), where ultimate control (over 25%) belongs to the Agnelli family and members of that family are also board members and part of management teams. U.S. examples of this are the Ford family, which maintains approximately 40% voting power, and the Sulzberger family, owners of the New York Times, where the family owns 18% of the company while maintaining voting control over board members through a special class of stock not available to outsiders (Lane et al, 2006).

Studies on the effect of corporate governance on financial stability are quite few as well nascent in nature probably due to lack of well defined financial stability. The same notion is noticed in corporate governance as a clear and generally accepted definition as well as measurement of the governance is still lacking.

Therefore, studies have been reset toward measuring financial soundness rather than financial stability, regardless of the size and content of such measurement (Das et al, 2004; Mishkin, 1991 and 1999). Adding financial and non-financial data of non-banking sectors has also shown remarkable results as corporate governance clearly declined especially in developing and less developed countries (Das et al, 2004). Also, it has been concluded that there are four vital elements for acceptable corporate governance. These interactive elements are independence, transparency, accountability, and integrity (Das and Quintyn, 2002). Further, Das et al, 2004 have produced another measure for organisational governance called RGI that is a mere weighted average of countries compliance with the aforementioned elements. Obviously, developed countries have higher average of corporate governance. It is worth mentioning that in their test for governance rates, Das et al (2004) have relied on three major parameters namely; the economic environment at large in the country -the financial status, inflation rates, and interest rates; the organisational structure of the banking system, and the infra structure for corporate governance such as the legislation, commercial laws, and governance in the public sector.

The effect of regulatory environments on the relation between corporate governance and firm valuation-as discussed by La Porta et al. (1998; 2000; 2002)-has been studied using aggregate corporate governance measures. Klapper and Love (2004) find, using a sample of 500 firms across 25 emerging countries, that firm-level corporate governance is most important in countries with poor investor protection. They note that a strong institutional setting may act as a substitute for firm-level corporate governance. Similarly, Durnev and Kim (2005) investigate the effect of legal environments on corporate governance practices in a multicountry setting. Using the CLSA database, they find for a sample of 859 firms in 27 countries that investment opportunities, the need for external financing and ownership structure all affect the quality of corporate governance. Furthermore, firms with better governance enjoy higher valuation as measured by Tobin's q. Most importantly, all these relations are stronger in less investor-friendly countries.

There is a serious amount of effort being placed into addressing corporate responsibility at the top of financial service organizations. Shareholders and regulators have made clear the need for organizations to tighten up their risk management, governance and compliance activities following a series of recent and high profile compliance failures and scandals (such as Enron) and the introduction of new rules and legislative changes to financial practice.

Sarbanes-Oxley Act (SARBOX) has the stated objective: 'to protect investors by improving the accuracy and reliability of corporate disclosures made pursuant to the security laws'. The rules set by SARBOX are very much in the public and media arena and firmly lay down the gauntlet for all financial organizations to meet stringent financial reporting and certification mandates by specific deadlines. Public and private companies alike must ensure their performance metrics are detailed, explained and auditable (Rogers, 2009). European accounting standards are also being updated to reflect the same sort of controls as SARBOX and the Financial Services Authority (FSA) is looking for far more detailed evidence from organizations through the reporting of sound operational governance.

The effectiveness of challenge at board level - in relation to the determination and approval of strategy, risk appetite and the management of risk - is identified by Walker report as a particular weakness (Walker, 2009). The report recommends that such shortcomings should be addressed by better leadership by the chairperson of the board, as well as non executive directors to have greater skills, experience, time and ultimately access to critical information particularly in relation to the present and future risk profile of the firm. In respect of risk governance, Walker makes a number of constructive suggestions in relation to the creation of a board risk committee that resulted in an ineffective challenge at some firms during the recent crisis (ACI, 2009).

As far as the effect of governance on performance is concerned, several scholars have tested the predictions of recent theories then linking those measures with corporate performance and dividend policy. In regard to performance, the results point to a sizable and robust effect of governance measure on both the return on assets and Tobin's q (Bebczuk, 2005; Das et al, 2004).

A great deal of attention has been given to understanding how corporate governance and ownership structures affect firm performance. Corporate governance can influence a firm's performance whenever a conflict of interest arises between management and shareholders and/or between controlling and minority shareholders. The root of both conflicts is the fact that the manager in the first case, and the controlling shareholders in the second case, receive only a portion of the firm's net revenue, while they fully appropriate the resources diverted (Bebczuk, 2005). Thus, it is conceivable that, in light of this incentive structure, insiders will maximize their (pecuniary and non-pecuniary) utility even when the firm as a whole will not. The ability to fulfil these goals is conditioned on the power insiders have in the company's decision-making process. (See La Porta et al., 1999, and Claessens et al., 1999; 2002).

Outsiders have two main instruments to counterbalance this power: the enforcement of adequate corporate governance standards and the quality of the regulatory and legal environment, which should discourage detrimental actions by insiders and, once committed, allow affected stakeholders to challenge them through corporate and judicial channels.

While a wedge between control and cash flow rights is likely to harm minority shareholders and corporate valuation, Jensen and Meckling (1976), Johnson, S. et al. (1999), and Morck, Shleifer and Vishny (1988) make the point that concentrated ownership may actually have an ambiguous beneficial effect on performance and valuation, the so-called incentive effect.

International evidence has greatly increased in the last few years. Claessens et al. (1999), Klapper and Love (2002) and La Porta et al. (2002) are prominent efforts in proving the nexus between corporate governance and performance using cross-country data, while other studies look at individual countries, such as the United States (see Gompers, Ishii and Metrick, 2003), Korea (see Black, Jang and Kim, 2003) and Germany (see Drobetz, Schillhoffer and Zimmermann, 2003). By aiming to analyze the relationship between corporate governance and ownership structure with performance (as measured by the return on assets and Tobin's q) in Argentina in 2000-2003, the present work forms part of the latter country-level line of research.

All in all, these and other studies have shown positive impact for corporate governance on the economy at large and on the management level as well. The overall interaction among factors affecting corporate governance either directly or indirectly has been named governance nexus which comply with the new institutional economics school (Alwazer, 2007). It is, thus, up to policy makers in a given country to mitigate corporate governance nexus to the betterment of the whole economic state and boost corporate performance.

The Study

Studies for long time have measured organizational dimensions on the enforcement of corporate governance and its effect on performance. These include the size of corporation, organization structure, and directors' compensation among other factors leading to effective corporate governance which enhance corporation performance (Baysinger and Butler, 1985).

The purpose of this study is to investigate perceptions toward the enforcement of corporate governance and its impact on management performance in the GCC. This requires in addition to survey analysis, testing for the variables effecting such perceptions among concerned parties. The perceptions of the concerned would thus, formulate a measure to test the possibility of enforcing such regulations and the likelihood for its success.

No doubt that such study is of paramount importance for the GCC as businesses are growing and just has recovered from the aftermath of the world financial crisis. There were some reported cases of scandals locally that have evolved the issue (IIF, 2009). Let alone, the tightened stiff regulations that have been passed by local authorities to regulate businesses in the region either as a response to international agencies requirements such as Basil requirements for banks, or in other cases obeying to local authorities like central banks and capital market authorities. Moreover, corporate governance once been adopted and enforced in a systematic manner, this would certainly improve business practices in the whole region leading to a code of best practices.

Hypothesis

A study of this kind has to commence from a point of similar studies in the field were variables have tested as correlated to the subject (Bauer et al, 2009). The lack of alike studies in the region, in addition to the nascent issue under investigation put constrain on the researcher freedom to select many variables for testing. The topic is seen more complicated as people tend to confront governance leading to restricting their natural capabilities to perform in a more flexible environment. This is widely noticed in different cultures and various business models all over the world (Almutairi, 2003).

Corporate governance in the region is at its embryonic stage where experiences are limited and some sort of confrontation is highly expected by decision makers to fully obey to its enforcement. It is actually driven by the notion that official regulation of the matter is absolutely scares as well as codes of practices in the same are so limited (Hawkamah, 2009). Thus, it is logical to base an empirical study on the hypothesis that independent variables of corporate governance have minimum effect on management performance. Therefore, the study has to test for the following hypothesis;

Hypothesis 1. Corporate governance enforcement has a positive impact on management performance in the GCC.

Hypothesis 2. Independent corporate governance variables have more effect on performance than dependent variables.

Dependent variables that would affect the testing of the sought relationship have no direct effect on management performance. The justification for this is basically driven from the premise that poor enforcement of corporate governance by local businesses is caused by their ultimate goals to mitigate performance and inflate their earnings. I believe that such notion, by itself is enough to explore perceptions toward the subject and test for its validity.

Methodology & Sample

For a study of this kind, one would have to lean to a recognized statistical testing as well as a basic arithmetic model to build up some relationships which may lead to some sort of correlations that assist in interpreting and determining perceptions toward the issue. Once concluded, then perceptions could be treated accordingly in order to achieve better enforcement of corporate governance among the growing business community in the whole region. In this case, a deductive research method is adopted to better identify the problem and reach some conclusions.

Moreover, it is obvious that the society for governance is very limited and classified as sensitive to cooperate and disclose what is considered of paramount importance and has the highest security level. No one should be allowed to get access to it albeit the fact that in most cases an access to such information will lead to almost nothing as governance is totally not documented, if rarely applied.

Therefore, the society sample has to be chosen based on a given parameter or recognized conditions. Since the only available way to get appropriate information is to rely on corporations published data and on interviews. Questionnaires, on the other hand, are avoided as the output of such mean would not necessarily reflect actually responses, thus the validity of testing, analysis, and results respectively are questioned. Many previous studies have end up utilizing similar methodology and resulted in valid and legitimate conclusions (Jean et al., 2004; Shah et al., 2009; Luohe et al., 2008; Good and Seow, 2002).

The sample contains at least 5 random corporations from each of the GCC countries in various sectors. Stock exchanges published data have been used to test for the variables. Years of published data range from 2007 to 2009.

The Variables

The study has multiple variables to test for. The independent variable assumed is corporate governance represented by the supervision, guidance and control of general assembly, board of directors, audit committee, external auditors, government's representatives, debtors, and general stakeholders. While on the other hand, dependent variables include reported earnings, financial leverage, cash distributions, share price, and management remunerations. The notion here is to explore the correlation among each of the dependent variables with respect to corporate governance as represented by its foresaid components. For example, if a corporation is reporting high financial leverage or reported earnings in any quarter, a correlation is tested for any change in any of the corporate governance components. Vis versa, a correlation test is made for more corporate governance enforcement to the financial performance.

The abbreviation given for all variables are as follows:

Independent Variable (Corporate Governance);

GA = General Assembly
BD = Board of Directors
AC = Audit Committee
EA = External Auditor
GR = Government Representatives
DB = Debtors
GS = General Stakeholders

Dependent Variables (Management Performance parameters);

RE = Reported Earnings
FL = Financial Leverage
CD = Cash Distributions
SP = Share Price
MR = Management remunerations

The General Model

In order to test for the correlation a general model was adopted to do the statistical analysis. It is as follows;

1. Measuring the earning power of a given corporate during a set period of time reflecting management performance for the same;

$$TACC_{i,t} = NI_{i,t} - OCF_{i,t}$$

TACC_{it} = Corporate Earnings of i company during t period;

ONI_{it} = Net operating income for I company during t period;

OCF_{it} = Net cash flow from operation for I company during t period;

2. Testing for regression analysis (β) regression for a given period;

$$\frac{TACCi,t}{Ait-1} = a + \beta 1 \left(\frac{1}{Ai,t-1} \right) + \beta 2 \left(\frac{\Delta REVi,t - \Delta RECi,t}{Ai,t1} \right) + \beta 3 \left(\frac{PPEi,t}{Ai,t-1} \right) + \varphi i,t$$

$$\left(- \right) + \beta 2 - (\quad - \Delta RECi,t) + \beta 3 (PPEi,t)$$

TACC i, t = Corporate Earnings of i company during t period;

$\Delta REVi, t$ = Change in company i earnings during period t ;

$\Delta RECi, t$ = Change in company i receivables during period t ;

PPE i, t = company i fixed asset during period t ;

$Ai, t - 1$ = company I total assets during the period t ;

$\varphi i, t$ = random error;

β = Beta (the regression)

α = fixed denominator

3. Determining non-discretionary earnings ($\beta 1, \beta 2, \beta 3, .. \beta n$) of the sample companies;

$$NDACCi,t = a + \beta 1 = () \quad \Delta REVi,t - 1$$

NDACC i, t = Non – discretionary earnings for company i , during period t ;

($\beta 1, \beta 2, \beta 3,$ = regressions denominators for the same period,

4. Determining discretionary earnings of each company at the same period;

$$DACCi,t = TACCi,t - NDACCi,t$$

DACC I,t = Discretionary earnings of the company I , during period t ;

TACC i, t = Corporate Earnings of i company during t period;

NDACC i, t = Non – discretionary earnings for company i , during period t ;

Statistical Tests

Using E-Views statistical software, statistical testing was made at a confidence level of 95%. This software was utilized in similar studies and positively resulted (Sekaran, 2006). Outputs of the testing include;

- Normal distribution test: to check for how close is the data to normal distribution through Jarque-Bera testing at a 5% probability;

- Multicollinearity test: using a Tolerance factor one would reach co linearity measure for the independent factor, then finding the Variance Inflation Factor (VIF) at 5% level;
- Autocorrelation test: to validate for any error in the testing, a Durbin Watson Test was performed;
- Heteroskedasticity test: utilizing White approach;
- Descriptive Statistical Measures: to extracts averaged data;
- Pooled Data Regression: to test for the time series analysis for the years (2005-2009), due to the fact that the data is cross sectional which call for a binary logit testing to explore correlation among inter-variables.

Statistical Analysis & Results

Statistical testing is shown in table 2 to table 5. Results indicate that normal distribution of the data is proportional to reported earnings and subsequently to management performance. Yet, through the Jarque-Beraa testing it was found that some of the corporate governance components have greater values in such distribution than others. For example, external auditors (128), board of directors (45.5), and debtors (32.4) have far exceed other factors such the general assembly or even government representatives in the corporations. By the same token, we see management remuneration has the only noticeable readable reflections to the aforementioned inter-independent variables. This could be interpreted as a normal reaction against the financial crisis waves that has impacted corporations major financial decisions which could involved the most concerned parties (the board, debtors, and external auditors).

As for the multicollinearity test, all VIF readings are below 5 which indicate that there is no multicollinearity problem among variables. This would flag the sign of validity as to the level of correlation among the same, without affecting the soundness of concluded results. On the other hand, the Durbin Watson (DW) test showed 1.982 calculated value which falls within the accepted range of 1.5-2.5. As known, DW values are usually within the range of 0-4. While values close to zero indicate positive correlation, values close to 4 indicate the opposite. The calculate value of 1.982 reflect confidence in the strength of the study model and its results.

In case of the Heteroskedasticity, it is considered as an important element in regression analysis. Moreover, for an advance testing, the White test is used once for multicollinearity assurance of the tested data. In our case, the White calculated value was 0.021, which is less than the generally accepted values for such testing. This again, indicates the validity of the multi-collinearity test and the extracted results, which in turn, reflect the inter-correlation among both independent as well as dependent variables. The descriptive analysis of the data is also indicating some sort of corporate governance significance. The mean of financial performance throughout year 2007, 2008, and 2009 subsequently is normal. The year 2009, however, showed lower values compared with 2007 and 2008 are logically expected. Due to the financial crisis, concerned parties

(general assembly, the board, and debtors) have assumed more responsibility which is indicated by the percentage of general assembly attendance (60-80%), audit committee meetings (25% increase), and lower rate of debts - less by 8% (33%-25%). Certainly, earnings would be less than before which in turn decreased the financial leverage by almost 3.5% (11.8-8.4%).

Table 2: Data Statistical Validity Test

| NO. | Variable | Normal distribution test | | Multicollinearity | |
|-----|---------------------------------|--------------------------------|-------|-------------------|-----------|
| | | Jarque - Bera test probability | J-B | VIF | Tolerance |
| 1 | CG: | 0.0 | 23.5 | - | - |
| 2 | GA (Annual / Semi-Annual) | 0.549 | 1.199 | 1.228 | 0.814 |
| 3 | BD | 0.010 | 128 | 1.634 | 0.612 |
| 4 | AC | 0.400 | 45.5 | 1.142 | 0.876 |
| 5 | EA | 0.815 | 0.408 | 1.478 | 0.677 |
| 6 | GR | 0.410 | 1.783 | 1.039 | 0.962 |
| 7 | D | 0.0 | 32.4 | 1.068 | 0.936 |
| 8 | GS | 0.795 | 0.459 | 1.010 | 0.990 |
| 9 | MP | - | - | 1.842 | 0.543 |
| 10 | RE | - | - | 1.323 | 0.756 |
| 11 | FL | - | - | 2.874 | 0.348 |
| 12 | CD | - | - | 1.096 | 0.912 |
| 13 | SP | - | - | 1.802 | 0.555 |
| 14 | MR | 0.871 | 0.276 | 1.074 | 0.931 |
| 15 | Auto correlation | | | 1.982 | |
| 16 | Heteroskedasticity (white test) | | | 0.021 | |

Table 3: Some Statistical Description - Averaged

| NO. | Variable | years | | |
|-----|-----------------------------|-----------|-----------|-----------|
| | | 2007 | 2008 | 2009 |
| 1 | Discretionary earnings (\$) | 12632500 | 17624400 | 11675230 |
| 2 | AGM Attendance | 55% | 62% | 66% |
| 3 | Board meetings | 4 | 6 | 4 |
| 4 | Non-executive % | 60% | 60% | 80% |
| 5 | Audit committee size | 3 | 3 | 4 |
| 6 | Audit committee meetings | 4 | 4 | 5 |
| 7 | Debts | 33% | 33% | 25% |
| 8 | Company size (\$) | 167747800 | 185407200 | 200594300 |
| 9 | Financial leverage | 14.25% | 11.8% | 8.4% |

Table 4: Correlated Statistical Descriptions

| NO. | Variable | 2007 | | 2008 | | 2009 | |
|-----|---------------------------|----------|--------------|----------|--------------|----------|--------------|
| | | realized | Not realized | realized | Not realized | realized | Not realized |
| 1 | CG: | 7 | 3 | 7 | 3 | 7 | 3 |
| 2 | GA (Annual / Semi-Annual) | 8 | 2 | 7 | 3 | 9 | 1 |
| 3 | BD | 7 | 3 | 8 | 2 | 8 | 2 |
| 4 | AC | 6 | 4 | 7 | 3 | 7 | 3 |
| 5 | EA | 7 | 3 | 8 | 2 | 8 | 2 |
| 6 | GR | 5 | 3 | 6 | 1 | 7 | 4 |
| 7 | D | 7 | 4 | 7 | 2 | 6 | 5 |
| 8 | GS | 4 | 3 | 5 | 1 | 4 | 3 |
| 9 | MP | 6 | 4 | 7 | 3 | 5 | 4 |
| 10 | RE | 4 | 4 | 6 | 4 | 3 | 4 |
| 11 | FL | 4 | 6 | 7 | 2 | 3 | 4 |
| 12 | CD | 4 | 5 | 6 | 2 | 4 | 6 |
| 13 | SP | 4 | 3 | 5 | 1 | 4 | 3 |
| 14 | MR | 6 | 4 | 7 | 3 | 5 | 4 |

Table 5: General Model Test

| | CG: | Probability | 2-statistic | coefficient |
|----|---------------------------|-------------|-------------|-------------|
| 1 | CG: | | | |
| 2 | GA (Annual / Semi-Annual) | 0.007 | 0.617- | 0.231 |
| 3 | BD | 0.218 | 3.193- | 0.002 |
| 4 | AC | 0.153 | 1.996- | 0.019 |
| 5 | EA | 0.011 | 1.279- | 0.210 |
| 6 | GR | 0.093 | 1.976- | 0.00 |
| 7 | D | 0.442 | 0.542- | 0.321 |
| 8 | GS | 0.399 | 1.822- | 0.041 |
| 9 | MP | 0.507 | 3.120- | 0.003 |
| 10 | RE | 0.406 | 2.914- | 0.004 |
| 11 | FL | 0.512 | 2.017- | 0.002 |
| 12 | CD | 0.486 | 2.641- | 0.005 |
| 13 | SP | 0.551 | 3.001- | 0.006 |
| 14 | MR | 0.622 | 3.144- | 0.007 |

All in all, some correlation is found among factors affecting corporate governance at the large scale with variables that are usually linked to corporate performance. This would suggest that further more elaborated in depth study seems to be a must in order to highlight the paramount importance of the issue in the GCC business environment.

Conclusion

While corporate governance standards in the region are being raised, some concluded remarks could be highlighted to bring the GCC into compliance with the IIF's corporate governance code. Any policy recommendation emerging from this research should take

into account that improving corporate governance entails the consideration of both the private and the public interest. Controlling shareholders will not be inclined to cooperate with such change unless the incremental benefits (acting as regular shareholders) outweigh the loss of their private benefits of control.

A stronger commitment to better corporate governance from political authorities as well as from senior government officials involved with capital market development is needed for real change to take effect. Regulators should quickly introduce corporate governance reforms in state-owned enterprises (SOEs), which are major contributors to the economies of the GCC. By requiring good standards of corporate governance from suppliers and private sector companies wishing to conduct business with SCCs, corporate sector reform can be expedited.

Regulators in the GCC need to work more closely together to strengthen the region's equity markets. With the exception of Saudi Arabia and Kuwait, equity markets in the region are relatively small and lack depth. Establishing a regional GCC corporate governance task force, comprised of regulators and market participants, would help to promote standardized, best-practice laws and regulations that would apply across all stock markets in the region. Standardization would help eliminate systemic risks by requiring companies issuing debt to obtain credit ratings, introduce stronger book building measures for IPOs, and promote the development of insider trading laws and investor education. Specialized courts to deal with the enforcement of securities laws also need to be established. This will expedite the delivery of justice for securities and finance-related offences and reduce the cost of litigation.

Increase financial transparency by harmonizing financial reporting requirements. Standardized financial reporting is especially needed for annual reports to shareholders. Establish a registrar of companies, requiring all companies (from sole proprietorship to joint stock companies) to provide information. This will help non-listed companies to develop better financial reporting practices.

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