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The impact of board independence and foreign ownership on financial and social performance of firms: evidence from the UAE

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Abstract

Purpose – This study examines the impact of two different types of foreign ownership—by Arab and non-Arab investors on firms' financial and social performance. It then goes on to investigate how the degree of board independence affects the aforementioned relationship between these two types of foreign investors on firm performance.

Design/methodology/approach – The sample for the study is a panel of all listed firms in the Dubai Financial Market (DFM) and the Abu Dhabi Securities exchange (ADX) from 2008 to 2012.

Findings – Results indicate that while Arab foreign ownership affects firms' financial and social performance negatively, non-Arab foreign ownership does so, positively. Further tests indicate that board independence weakens the negative relationship between firm financial and social performance with foreign Arab ownership and deteriorate the relationship between firm financial and social performance and non-Arab foreign ownership.

Research limitations/implications – Future studies may extend the coverage of the study by including other countries in the region and other identities of the foreign investors.

Practical implications – This study may help policy makers in the UAE to improve the implementation and enforcement of existing regulations concerning corporate social responsibility (CSR) and board independence. It also highlights the need to look into the monitoring role of independent board members.

Originality/value – This is the first study to examine the role of board independence on the relationship between foreign ownership and firm's financial and social performance. To the best of our knowledge, this is the first paper that attempts to enrich the understanding of foreign ownership by classifying it into Arab versus non-Arab.

Keywords Ownership, Board independence, Firm performance, Social performance, The UAE

Paper type Research paper

1. Introduction

Foreign investment is one of the key engines to economic growth in any country. Governments constantly endeavor to attract foreign investment in order to create new jobs, develop economic infrastructure and attract new technologies and management styles. In order to be able to do this, governments attempt to create a better business environment for foreign investors in the form of strong investment protection, good corporate governance and

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tax reductions. Corporate governance mechanisms have important implications for firms' financial policies and investor protection (Hussainey and Aljifri (2012).

According to the United Nations Conference on Trade and Development (UNCTAD), the United Arab Emirates (UAE) was the third largest destination to attract foreign investments in West Asia between 2003 and 2008. The UAE is a pioneer in construction growth and business opportunities. It is ranked first in terms of construction profitability and among the fastest growing countries around the globe (Langdon, 2008; 2012). With the high foreign investment inflow into the UAE, foreign ownership has become an integral part in the ownership structure of companies.

However, this growth has come in the face of several challenges. For example, a net withdrawal of foreign investment of AED 11.5bn was recorded in 2008. This negative outflow of foreign investment from the UAE's markets raises many questions of investors' protection and the role of corporate governance in the UAE. This study examines whether return or firm performance influences foreign investors to sell their shares and the role of independence boards in protecting foreign investors.

In 2009, the Emirates securities market decreased dramatically with a 70% decline in the Abu Dhabi Securities Exchange (ADX), and a 43.2% decline in the Dubai Financial Market (DFM). Stock market performance has an influence on the performance of firms and the type of ownership plays a major role in firms' financial (Liu *et al.*, 2012) and social performance (e.g Khan *et al.*, 2013; McGuinness *et al.*, 2017; Oh *et al.*, 2011). Jensen and Meckling (1976) were by far the first to highlight the distribution of share ownership between owners and how this allocation can affect both the firm's financial and social performance.

Since then, ownership structure has been considered theoretically and empirically as a significant explanatory mechanism that could influence firm's financial and social performance. In general, it is believed that foreign investors have better capability to manage firms, usually through use of advanced technology, experience in business and innovative ideas to turn companies around (Huang and Shiu, 2009). Moreover, foreign investors may be more inclined to pay attention to social issues because of their familiarity with these issues, higher sensitivity to such matters and therefore, greater emphasis on corporate social responsibility (CSR) in their home countries. This is more so because of the emerging role of CSR engagement as an important signaling mechanism that may reduce uncertainty and information asymmetry in the securities market.

Additionally, foreign investors may be forced to be far-sighted rather than myopic, because they may find it difficult to dispose their holdings without significantly affecting stock price. Foreign investors, therefore, are *a priori* more likely to advocate firms' engagement in CSR as they may perceive CSR activities as means of facilitating firm survival in the long run.

However, results regarding the relationship between foreign ownership and firms' financial and social performance effort are rather mixed (Sanchez-Ballesta and Garcia-Meca, 2007). For instance, a host of prior studies report a positive association between foreign investment and firms' financial and social performance (e.g Haniffa and Cooke, 2005; Khan *et al.*, 2013; McGuinness *et al.*, 2017; Oh *et al.*, 2011; Sukumara, 2017). On the other hand, some document no relationship at all (e.g Azlan and Devi., 2008; Cahyani and Suryaningsih, 2016; Roshima *et al.*, 2009). The reason for this inconsistency could be the fact that the extant literature considers foreign investors to be a homogeneous group, representing similar features and traits. However, we postulate that the heterogeneity in attitude and behavior of the investors themselves can differentially influence firm strategies. This is something that has not been explored in prior studies.

Therefore, and to bridge the gap in the prior literature, we classify foreign ownership into two categories, based on their identities into Arab and non-Arab investors' equity holding.

We expect differences in the impact of these two groups on firm behavior and performance for two reasons.

First, Arab foreign investors share a common culture, religion and language with companies in the UAE and in addition, their countries are mostly classified as developing countries. Chahine and Tohmé (2009) argue that non-Arab foreign shareholders in the Arab countries outperform their domestic counterparts in term of experience, credibility and monitoring capabilities.

Second, as argued earlier, foreign investors have better capabilities to run companies (Huang and Shiu, 2009). Strong foreign investors who have such capabilities are known to come from developed countries with experience in certain business background and dealing with financial and social issues. However, the situation is rather different with the rapid growth of developing economies and the large investments by investors now pouring in from these countries. While these investors may have the financial resources to invest, they lack the innovation of developed-economies' investors. Therefore, it is not *a priori* clear whether the argument above still holds. For instance, few studies find a negative influence of foreign ownership on firm performance (Phung and Le, 2013).

We then go on to examine the role of independent board members in influencing the relationship between foreign ownership in general and these two types of foreign ownership and firm financial and social performance. Board independence is considered a crucial corporate governance mechanism in disciplining the management and protecting the interests of minority shareholders. Muniandy and Hillier (2015) argue that board independence is crucial for attracting foreign investment. Moreover, a review of the literature indicates that board independence enhances a firm's financial (Conyon and Peck, 1998; Weisbach, 1988; Brown and Caylor, 2009) and social performance (e.g Badrul and Nava, 2015; Jo and Harjoto, 2012; Post *et al.*, 2011; Zhang *et al.*, 2013).

Even though financial and social issues are one of the most urgent issues attracting the attention of practitioners and academic researchers worldwide, few studies have focused attention on the determinants of firms' financial and social performance, particularly the impact of differential foreign ownership. We believe this to be a significant contribution of this paper particularly as social performance becomes an important determinant for improving the corporate image and attracting customers

Research on the role of foreign ownership in the UAE is scarce although there is a dramatic increase in foreign ownership in the UAE. Additionally, financial scandals and high-profile environmental disasters have heightened the scrutiny over firms' financial and social performance on a global scale. Finally, Shahzad and Jamal (2008) point out that traditional societies in developing nations are not conducive for the adoption of western-styled rational corporate governance models. Many companies in Gulf countries including the UAE have implemented CSR, corporate governance guidelines and codes that mirror those adopted by firms in western countries, where the stakeholder awareness of company accountability is high. Given that capital markets in developing economies are still maturing and their institutional, social, legal and regulatory frameworks differ from those of developed nations, it is worthwhile studying the impact of foreign ownership and board independence on the UAE firms' financial and social performance.

This article makes three major contributions. First, the role of foreign ownership has been widely studied in governance and the finance literature. However, little focus has been laid on the identity of these foreign investors. Most prior studies treat foreign investors as one, homogenous category with the same characteristics and nuances. To the best of our knowledge, this research is the first to use a detailed dataset to investigate foreign ownership identities in the UAE. The study highlights the critical influence of two different foreign investor identities on firm financial and social performance, a topic that has not received the attention that we believe it deserves. The results also extend our knowledge as to why the identity of foreign investors differs in influencing performance.

Second, this article integrates board independence with the relationship between foreign investors and firm financial and social performance. The empirical approach we take expands our understanding as to how board independence impacts different types of foreign investors influence on firm performance. At a policy level, the study could help improve the implementation and enforcement of existing regulations concerning CSR and board independence.

Third, most evidence till date, on the relationship between foreign ownership and firm performance is for developed economies. However, there is still a need to investigate the relationship in the context of the UAE, whose financial landscape and attractiveness as an investment destination make it rather unique.

2. An overview of the UAE

The UAE, established in 1971, is a country in the Middle East, made up of seven emirates—Abu Dhabi, Dubai, Sharjah, Ajman, Umm al-Quwain, Ras al-Khaimah and Fujairah. It is an open economy with a federal government system. Abu Dhabi and Dubai are the key drivers of the UAE's economy as they hold around 85% of the UAE's GDP. About 68% of the UAE's population is located in both these emirates (C.I.A, 2009).

The UAE has two main stock markets: ADX and DFM. The stock market regulator for both these markets is the Securities and Commodities Authority (SCA). The SCA was established in 2000 under law No.4 of the year 2000. The SCA administers and links the ADX and DFM and is responsible for enforcing the corporate governance code and other regulations by the listed firms in both markets.

The SCA provides daily reports of the performance and trading activities of both markets and companies. It issues a daily index of the ESM (also called the SCA index) which is officially the index of both markets. It also provides live market watch screens in different cities around the country. There is an annual report and several brochures issued by the SCA which contain the activities and other data of companies of both markets which is a rich source of information.

The ADX, established on November 12th, 2000, is the main stock market in the UAE. It is financially independent, has legal, autonomous status and an independent management, which enable it to discharge its responsibilities in a fair manner. The ADX has several main objectives. It aims to achieve sustainable growth of the national economy by providing opportunities to the public for savings and investments. In addition, it also seeks to establish principles for ensuring investor protection.

The ADX exercises strict control over securities' transactions and promotes investor education. It attempts to regulate and maintain reasonable levels of supply and demand through the regulation of transactions. It also focuses on maintaining price stability and liquidity of securities listed on the market. The DFM is the second stock market in the UAE which was launched by Resolution No.14 of the year 2000. The DFM provides good environment for trading stocks of public companies or any bonds issued by the local and the federal government and other institutions. It also trades foreign or local units of investment funds or any other financial instruments. According to the UNCTAD, the UAE was the third largest attraction for foreign direct investments in West Asia between 2003 and 2008. A total of 150 corporations of the Fortune 500 companies are represented in Dubai, including the top ten. In addition, the UAE has 23 free zones which attract several multinational and foreign firms from all over the world. Jabal Ali is one of the free zones and is considered as one of the largest zones in the world, hosting around 5,000 companies from over 100 countries globally (CRA, 2007). Dubai is considered the third re-exporter center after Hong Kong and Singapore and is an important center for international trade.

The UAE has also top-rated institutions, both regionally and globally. The largest sovereign wealth fund in the world is in the UAE. The Abu Dhabi Investment Authority (ADIA), for example, holds an approximate wealth of US$ 750 to 900bn (Abdelal, 2009). The Dubai International Financial Center (DIFC) is a financial hub for the Middle Eastern region. It aims to provide a total view of international standards regarding business rules and regulations that meet the local environment in creating sustainable economic development in the region. The Hawkama Institute for Corporate Governance (HICG) is also a unique institution in the region which was created in 2005. It was established to assist the UAE and businesses in the region to adopt and implement corporate governance frameworks of a high quality.

To build trust and gain investors' confidence, the government of the UAE promoted reliable legislation, including corporate governance regulations. Therefore, the SCA introduced its first version of the corporate governance code in 2007. The final version of the code was passed in 2009, making it applicable to all listed firms on the ADX and the DFM, starting April, 2010.

The corporate governance code is mainly based on the international governance standards. The Code consists of 16 main articles that incorporate all the aspects of corporate governance in a firm. The third article sets the method for the appointment of the board of directors, with emphasis on board independence. Criteria for "independence" are also described in the same article.

The third article stipulates that at least one-third of the board members shall be independent. It defines an "independent director" as one who is not, nor her/his spouse, nor his/her other first-degree relative, a member of the management of the firm during the last two years of the appointment or has any financial deals with the firm, the sister firm, parent firm or any related firm during the last two years if the total amount of the transactions is 5 million AED or more than 5% of the paid up capital of the firm.

The corporate governance code is expected to increase investor confidence and protect their interests. However, the Arab investment infrastructure in general, despite its recent growth, remains less developed than its western counterparts. Arab countries continue to have weak regulatory frameworks and markets for corporate control. In the presence of poor external governance mechanisms such as these, internal corporate governance assumes a more important role in addressing agency problems. In terms of ownership, Arab firms typically demonstrate concentration of ownership with strong family and political influence (Chahine and Tohmé, 2009). Therefore, one expects governance mechanisms such as board independence to be more effective in addressing agency problems than traditional mechanisms such as board size or number of board meetings. Independence can be indicative of the exercise of power and the extent of managerial domination of Arab investors who usually act as board members (Chahine and Tohmé, 2009)

3. Literature review and hypothesis development

3.1 Foreign ownership and firm financial performance

The prior literature suggests that foreign firms investing abroad have superior utilizable capabilities compared to their domestic peers (Buckley and Casson, 1976, 2003; Dunning, 1988; Porter, 2011). Agency Theory attempts to explain the relationship between different types of ownership concentration with firm performance, including the role of foreign concentrated ownership (Chhibber and Majumdar, 1999). Agency Theory argues that the existence of foreign ownership in a firm is associated with better firm performance (Haat *et al.*, 2008). Hingorani, Lehn, and Makhija (1997) conclude that foreign ownership reduces agency problems by better aligning the interests of shareholders and management.

It is assumed that the increase in foreign ownership in a firm, irrespective of industry-type, is associated with better performance, owing to superior capability and management experience of foreign firms *vis-a-vis* their domestic counterparts (Caves, 2007). Some of the earlier studies observe such direct effects of foreign ownership with particular reference to OECD countries (Dunning and Pearce, 1977; Forsyth and Docherty, 1972; Globerman, 1979).

Recent empirical studies demonstrate that the relationship between foreign ownership and firm performance is rather unclear, or mixed. It is argued that foreign involvement in the ownership of a firm might have different effects on firm performance. Several studies have investigated the association between foreign ownership and firm performance around the world and at different periods of time (Akimova and Schwödiauer, 2004; Arouri *et al.*, 2014; Aydin *et al.*, 2007; Douma *et al.*, 2006; Goethals and Ooghe, 1997; Gunduz and Tatoglu, 2003; Isik *et al.*, 2004; Khawar, 2003; Yudaeva *et al.*, 2003; Zheka, 2005).

Arouri *et al.* (2014) examine the relationship between foreign ownership and firm performance for banks in the Gulf region. They find that the involvement of foreign investors in the ownership structure of a firm improves its performance. Aydin *et al.* (2007) compare the performance of firms owned by foreign investors with those owned by local shareholders, for all listed firms on the Istanbul Stock Exchange (ISE) for the years 2003 and 2004. They find that firms with foreign ownership perform better than those with no foreign involvement.

Yudaeva *et al.* (2003) compare the productivity of domestic Russian firms to those with foreign ownership. Results indicate that firms with foreign involvement are more productive than the domestic Russian firms. They attribute the results to better management and access to superior technology for foreign-owned firms.

Many other studies have documented the positive relationship between foreign ownership and firm performance. Among others, Goethals and Ooghe (1997) compare the performance of Belgian domestic and foreign-owned companies. Gunduz and Tatoglu (2003) examine non-financial firms listed on ISE. Isik *et al.* (2004) study Turkish banks during the period between 1981 and 1990. Other studies document similar positive results (Boubakri *et al.*, 2005; Khawar, 2003).

Some other studies in this area of research have investigated unique characteristics of firms with foreign ownership which can influence the relationship between foreign ownership and firm performance. For example, Douma *et al.* (2006) adopt a multi-theoretic approach to examine the influence of different types of foreign corporate shareholders and foreign institutions on firm performance of promising markets. They find that the positive relationship between foreign ownership and firm performance is driven by foreign firms that have higher commitment, larger ownership and longer involvement. They also document a positive impact of foreign ownership on the performance of financial institutions which differs based on the business group affiliation of firms.

Chhibber and Majumdar (1999) examine the impact of foreign involvement on the performance of firms listed on the Bombay Stock Exchange. They classify foreign ownership according to different levels of the firms' ownership control. These categories are defined based on the Indian institutional environment that helps define property rights accruing at different levels of ownership. Return on sales (ROS) and ROA are used to measure firm performance. Results indicate that foreign ownership has a significantly positive influence on various dimensions of firm performance. The UAE is one of the most attractive countries for foreign investment in the Middle East. However, there is a withdrawal of foreign investors from the market after the financial crisis, which makes it a worthwhile for this study to investigate the performance of foreign investors in the UAE in the period of the study. Therefore, and building on the literature outlined so far, we develop the following hypothesis:

H1a. Foreign ownership is positively associated with firm financial performance.

On the contrary, some other studies document that the positive influence of foreign ownership on firm performance may not always hold or may vary by ownership levels. Akimova and Schwödiauer (2004) examine the impact of ownership structure on corporate governance and performance of 202 large and medium Ukrainian firms for the period 1998–2000. They find that of all types of ownership, firm performance is most strongly associated with foreign ownership. They also find that the influence of foreign ownership on performance is positive only up to the point where ownership falls short of majority holding.

Of the crisis-hit economies, Choi and Hasan (2005) study Korean commercial banks from 1998–2002 and find a significantly positive relationship between foreign involvement and bank performance measured using different indicators. While they find no statistically significant relationship at low levels of foreign ownership, bank risk and returns are significantly and positively associated with high levels of foreign ownership.

On the other hand, Phung and Le (2013) examine the relationship for listed firms on Vietnam's Ho Chi Minh Stock Exchange during the period 2008–2011. They find that foreign ownership has a negative impact on firm performance for firms in Vietnam. They also conclude that the monitoring role of foreign ownership in emerging economies is weaker, owing to weak corporate governance and information asymmetry in these economies.

Phung and Mishra (2016) find that foreign ownership positively influences firm performance only up to a certain level, beyond which the relationship turns negative. Praptiningsih (2009) investigate firms in Asian emerging markets and conclude that foreign ownership has a significantly negative influence on firm performance. Zheka (2005) also examines the influence of different ownership types on the efficiency and quality of corporate governance. Using a sample of Ukrainian firms for the period 2000–2001, he finds that foreign affiliation in firms does not enhance performance.

Based on the literature examined so far, foreign investors have better technological and financial resources and the experience to manage investments. This in turn enhances firm efficiency and performance. However, different studies have documented largely, a negative or non-linear relationship between foreign ownership and firm performance.

We argue that "effective" foreign investors who possess superior capability and management skills come from developed countries. The current foreign investment situation is different, with the rise of developing economies and the large investments made by wealthy investors from these countries. These investors might have the financial resources but hardly have the innovation that investors of developed economies possess.

To empirically investigate this hypothesis, we classify foreign ownership in the UAE into two categories—foreign Arab investors and foreign non-Arab investors. Arab countries are commonly believed to be less developed than non-Arab ones.

Foreign investors are more likely to encourage a participative management style whereas Arab investors tend to favor an authoritative management style with strong influence from family, political and tribal ties (Chahine and Tohmé, 2009). Also, Ali (1995) argues that Arab management style suffers from fragmented culture and past history that is not supportive for enhancing today's management practice. We therefore, hypothesize the following:

H1b. Non-Arab foreign investors outperform Arab foreign investors in influencing firm financial performance.

3.2 Foreign ownership, board independence and firm financial performance

Muniandy and Hillier (2015) find that board independence has a positive, synergistic effect in congruence with other variables in influencing firm performance. They argue that independence of the board is important for growth in the firm's financial performance. P. Brown *et al.* (2011) assert that the independence of the board has a crucial role to play in the monitoring effectiveness of the board. And since large shareholders may have more power than minority shareholders, strong monitoring is needed to align the interests of the minority and majority shareholders (Jensen and Meckling, 1976).

Several studies have documented the positive role of board independence in protecting shareholders' interest (Conyon and Peck, 1998; Weisbach, 1988). Black *et al.* (2006) and L. Brown and Caylor (2009) report an influence of the proportion of independent directors on the board on firm performance. However, other studies find no significant role of independent board in influencing firm performance (Goh *et al.*, 2014; R. Haniffa and Hudaib, 2006; van Essen *et al.*, 2012)

To date, results on the association between board independence and firm performance remain mixed at best. Adams *et al.* (2010) and Goh *et al.* (2014) argue that the role of board independence can be better understood as a moderating mechanism.

Governance mechanisms such as board independence are expected to be more effective in addressing agency problems and monitoring than any typical governance mechanisms. Independence can be indicative of the exercise of power and the extent of managerial domination of Arab investors who usually act as board members (Chahine and Tohmé, 2009). Independent boards in the environment of the UAE are crucial particularly among firms with foreign investors. Ali (1995) argues that the political and economic crises in the region show how the Arab states are cautious of foreign influence which motivates investigating board independent in firms with foreign investors.

The role of independent boards might be more pronounced when studied with foreign investment holding. Therefore, we conjecture the following hypotheses:

H2a. The relationship between foreign investor holding and financial performance of the firm is influenced by a higher proportion of independent directors on the board.

H2b. The relationship between non-Arab foreign investor holding and financial performance of the firm is influenced by a higher proportion of independent directors on the board.

H2c. The relationship between Arab foreign investor holding and financial performance of the firm is influenced by a higher proportion of independent directors on the board.

3.3 Foreign ownership and firm social performance

A review of literature indicates that key shareholders exert direct influence on organizational decision-making, motivation and power (Finkelstein, 1992). For example, the key shareholders can affect a company's decision to invest, by proposing and voting on the company's strategic decisions through different conduits (Oh *et al.*, 2011). One area the key shareholders may involve themselves in the company's strategic decision-making is in the area of CSR investment.

In recent times, CSR has received a significant amount of attention from both business practitioners and academic researchers (Oh *et al.*, 2011; Panicker, 2017). Several determinants of CSR spending have been investigated in prior research. Even when investment in CSR is influenced by the choices, motives and values of those who are involved in formulating and taking decisions in the company, ownership structure continues to be an important determinant (Khan *et al.*, 2013). In the case of UAE, one of the key shareholders is foreign investors. This is because foreigners may hold a substantial number of shares in UAE corporations.

Foreign investors differ from their domestic counterparts with regard to preferences, familiarity, time horizons and the extent of information asymmetry (Panicker, 2017; Oh *et al.*, 2011). For example, foreign investors with a long-term investment horizon are more likely to consider a company's social behavior as a material investment decision that can increase the likelihood of long-term survival of the company. Moreover, foreign investors are expected to be more familiar with social and environmental issues because of their foreign market exposure (Khan *et al.*, 2013). Finally, foreign investors are subject to greater information asymmetry stemming from separation of ownership between managers and shareholders geographically and are at a greater risk resulting from investing in a foreign country (Huafang and Jianguo, 2007; Gehrig, 1993).

Therefore, these investors would most likely prefer to invest in socially responsible firms, since increased CSR engagement is viewed as tool to reduce information asymmetry and risk (Oh *et al.*, 2011). A growing body of the literature has explored the association between foreign ownership and CSR practices in both developed and developing countries. None of the studies, however, investigate the impact of foreign ownership on CSR activities in the UAE.

In the Asian context, Haniffah and Cooke (2005), Khan *et al.* (2013) and Panicker (2017) provide empirical evidence that foreign ownership is positively associated with CSR performance. By examining the determinants of CSR disclosure quality in both voluntary and mandatory CSR reporting regimes, the findings of Zainal (2017) indicate that the quality of CSR reporting increases with a higher proportion of foreign ownership in the firm. Using Korean and Chinese firm data, Oh *et al.* (2011) and McGuninness *et al.* (2017), respectively document higher CSR rating in firms with greater institutional and foreign ownership. Suzuki and Tanimoto (2005) find that the presence of high foreign ownership in Japanese public companies leads the companies to seriously embark on CSR and display greater CSR performance.

Using Egyptian data for the period 2007–2009, Soliman *et al.* (2012) document a positive relationship between foreign ownership and social performance. Muttakin and Subramaniam (2015) document a similar positive association. They also find that community, environmental, employed/human resources and product and services information increases with foreign ownership.

In the light of the institutional theory, involving oneself in CSR practices is seen as a proactive, legitimate strategy to gain continued inflow of capital and please ethical investors (Muttakin and Subramaniam, 2015). Companies usually communicate their concern about social and environmental issues in order to legitimize their existence in the eyes of investors (Amran and Devi, 2008). Given the fact that substantial funds in the UAE's capital market come from foreign investors, UAE companies are expected to engage more in CSR activities to satisfy these foreign investors.

Moreover, foreign investors, such as those from developed countries, possess long standing and more ingrained attitudes toward CSR (McGuinness *et al.*, 2017). As argued earlier, companies may invest in CSR as a way to signal their trustworthiness and, therefore, foreign investors may prefer to invest in companies with high CSR rating to minimize risk and uncertainty (Oh *et al.*, 2011). Having made their investment based on CSR rating, foreign shareholders are more likely to create coercive pressure for local firms to seriously embrace CSR to avoid loss of investment due to regulatory sanctions or bankruptcy. Thus, we conjecture that foreign investors would demand UAE companies to display greater CSR performance and by doing so, companies will continue to attract more investments as well as keep the current ones. Based on the institutional theory, we formulate the following hypothesis:

H3a. Foreign ownership is positively associated with firm social performance.

It has been argued that not all foreign investors are always supportive of social investments (Oh *et al.*, 2011). Anecdotally, some corporations with foreign investors have been involved in anti-social behavior (Davis and Kim, 2007; Yoshikawa *et al.*, 2010). Thus, it becomes necessary to identify the identity of foreign investors that could help identify their investments orientation and preferences. This, we believe, can help to better affirm the positive foreign ownership-CSR relationship and enrich the literature on foreign ownership and social performance. Moreover, how the identity of foreign investors impacts social performance has yet to be explored.

Wasowska (2013) postulates that ownership characteristics determine the different goals, mode of operations and preferred use of resources available to a company. Additionally, Haniffa and Cooke (2005) suggest considering the values, motives and choices of those involved in CSR-related decisions within the company. Extant literature also supports this line of argument (Amran and Devi, 2008, Said *et al.*, 2009, Meutia *et al.*, 2017, Swandari and Sadikin, 2016, and Cahyani and Suryaningsih, 2016) who found foreign ownership has no significant influence on CSR.

In the UAE, non-Arab investors come usually from developed countries where CSR is seen as both necessary and desirable. Therefore, compared to Arab investors, non-Arab foreign investors are expected to be more familiar with social and environmental issues and have greater emphasis on CSR in their home countries. The lack of understanding of the importance of CSR activities and the potential benefits of engaging in them are obstacles that have left developing countries lagging behind, in terms of CSR (Meutia *et al.*, 2017).

Since non-Arab foreign investors from developed countries are in favor of active CSR engagement, the investors might perceive social investments as means that lead to increased chances of long-term survival of a corporation and not as a way of squandering the company's resources for charity and other non-business-related expenditures. Furthermore, the weaker political ties non-Arab foreign investors have with local government may incline them to promote CSR practices much more strongly in a hope to expand their network in the UAE firms they invest in as well as for the firms to have easy access to bank funding and to obtain government subsidies.

It has been believed that CSR in developing countries is still rooted in a more philanthropic culture where there is still emphasis on formal accountability processes (Jamali and Mirshak, 2007).

Moreover, Dyck *et al.* (2017) argue that foreign investors play an active role in driving the social performance of a company only if they are from countries with a strong CSR culture. Since investors from developed countries prefer active CSR engagement, they are likely to exert their power on local firms. In the light of underlying differences in socio-cultural factors between Arab and non-Arab foreign investors discussed above, we conjecture that non-Arab foreign investors with significant shareholding can exert pressure on UAE companies to actively engage in CSR activities. This assumption is formulated in the following hypothesis:

H3b. Firms with higher levels of non-Arab foreign ownership are more likely to exhibit greater social performance, compared to their counterparts.

3.4 Foreign ownership, board independence and firm social performance

A company's board of directors is the main body responsible for designing, implementing and improving the firm's contribution to sustainable development and well-being (Ortas *et al.*, 2017). The board is also responsible for defining the company's objectives and the strategies to attain them (Jo and Harjoto, 2012; Zahm, 1989). It is in the best interest of companies therefore, to have effective boards whose members take into account the wider interest of all stakeholders and be champions for good CSR practices (Welford, 2007).

The best way to ensure effective boards that act in tandem with good CSR practices is to make sure that they have a good number of independent members. Evan and Freeman (1988) argue that owing to the experience and expertise that independent directors bring on board, their induction allows firms to develop strategic policies that address a wider range of key stakeholder needs and claims. Moreover, instrumental stakeholder theory alleges that independent board members are more likely to be committed to CSR and also satisfy the legitimate interest of key stakeholders (Freeman, 1984).

A review of the literature indicates that outside directors have different time horizons, values and attitudes toward CSR activities compared to their insider counterparts. Outside directors are less attentive than insiders to investors' wealth maximization goal and appear to be more concerned with CSR (Ibrahim and Angelidis, 1995; Ibrahim *et al.*, 2003). Unlike the remuneration of top managers, independent directors' remuneration is not linked to the firm's financial performance. Therefore, independent directors are less likely to prioritize short-term financial performance targets and more likely to place greater value on the firm's long-term sustainability (Ibrahim *et al.*, 2003; Jizi *et al.*, 2014).

Johnson and Greening (1999) assert that outside directors display more interest in complying with environmental standards than insiders (Johnson and Greening, 1999). Moreover, relative to insiders, outside directors are found to pay more attention to philanthropic activities (Ibrahim *et al.*, 2003). This is because outside directors may feel that advocating investments in environmental and philanthropic areas is the best way to increase the long-term sustainability of a firm (Post *et al.*, 2011). Given these differences between insiders and outsiders with respect to CSR behavior, one can expect that firms with a higher proportion of independent directors on board display greater concern for CSR performance.

A vast body of research suggests that independent boards can play an effective role in improving CSR performance. For example, using a sample of 2,039 US firms, Jo and Harjoto (2012) document a positive impact of board independence on CSR performance. Similarly, Zhang *et al.* (2013) focus on the 500 largest companies listed on the US stock exchanges and document that a larger presence of independent directors on the board allows firms to obtain better levels of CSR spending. In the same vein, Zahm (1989) concludes that firms with more independent boards generally experience higher levels of CSR performance.

Jizi *et al.* (2014) examine a sample of large US commercial banks and report a positive relationship between board independence and CSR performance. Similarly, Post *et al.* (2011) analyze 78 Fortune 1,000 firms and provide empirical evidence of a positive impact of the independence of board on CSR performance. Khan (2010) examines a sample of Bangladesh banks and concludes that an increased board representation of independent directors results in higher CSR performance for the banks.

In a related vein, Lone *et al.* (2016) analyze a sample of 50 firms in Pakistan and document a positive relationship between the independence of boards and CSR performance. Huang (2015) uses a sample of 297 electronic firms operating in Taiwan and finds that the presence of independent members on firms' boards has a positive impact on social performance.

Using a sample of 300 large Australian firms, Galbreath (2017) finds that a higher proportion of inside directors on a company's board decreases CSR performance. Ortas *et al.* (2017), using a meta-analysis approach, document that firms with more independent directors exhibit greater CSR performance. Other studies that document a similar positive board independence- CSR performance relationship are Dunn and Sainty (2009), Sahin *et al.* (2011). Khan *et al.* (2013), Nitm and Soobaroyen (2013), and Muttakin and Subramaniam (2015).

Consistent with the overinvestment hypothesis, however, managers are more inclined to overinvest in CSR to increase their private benefits of reputation-building as good social citizens, probably at the expense of shareholders (Barnea and Rubin, 2010). Overconfident managers who are not closely monitored may squander corporate resources in value-destroying investments (Goel and Takor, 2008) as those managers may prefer to enjoy a quiet life rather than active empire building (Bertrand and Mullainanthan, 2003). Since well-designed corporate governance systems prevent overinvestment, one can expect a negative relation between board independence and CSR performance.

Extant empirical research also suggests that board independence can inversely impact CSR performance (e.g. Hanniffa and Cook, 2005; Orti z-de-Mandojana, 2016). Moreover, most companies in developing countries are owned and controlled by family members who often also run the firms (Welford, 2007). Usually, the priority of these family members is to increase their own wealth and retain control on firms in their ownership (Welford, 2007). Therefore, they may see little need for investment in CSR activities and increasing transparency.

As family members are in a position to choose and elect board members, one can realize that independent directors in such cases would be much less likely to exercise their power to ensure managerial compliance with social expectations of the firm. Welford (2007) argues that independent directors in Asian countries sometimes act deferentially to management in the hope of maintaining their remunerated positions. Furthermore, Sobhan and Wemer (2003) conclude that due to family dominance, the presence of independent directors on boards of companies in developing countries tends to be largely ceremonial. Keeping in line with the discussion above, the following hypotheses are formulated:

H4a. The relationship between foreign investors' holding and the firm's social performance is influenced by a higher proportion of independent directors.

H4b. The relationship between non-Arab foreign investors' holding and the firm's social performance is influenced by a higher proportion of independent directors.

H4c. The relationship between Arab foreign investors' holding and the firm's social performance is influenced by a higher proportion of independent directors.

4. Research methodology

4.1 Data collection

We employ a firm-level panel dataset over the period 2008–2012 of all listed firms on ADX and DFM. Both markets have an average of 128 listed firms per year as shown in Table 1. For the purpose of this paper, we collected the board independence and social performance data manually from the annual reports, corporate governance reports and other stock market reports. Data on foreign and institutional ownership were collected from the websites of the respective stock markets as well as from the guides of listed companies and annual bulletins which are available on the websites of the stock markets and the SCA.

Finally, financial data were collected from the Thomson Financial DataStream database. Consistent with the literature, we exclude foreign firms and firms with missing data on required variables (192 firm-year observations in five years). Our final dataset is an unbalanced panel of 451 firm-year observations for the years 2008–2012. The distribution of the sample can be seen in Table 1.

We targeted the period from 2008 to 2012 for several reasons. First, this period is following the first introduction of the corporate governance code in the UAE in April 2007 and during the implementation. Second, it was a period of economic downturn of what started as the global financial crisis in 2008 and extended to the subsequent Great

Table 1.
Sample distribution by year and financial market

	Population		Excluded information		Final sample		
Years	ADX	DFM	ADX	DFM	ADX	DFM	Total
2008	65	65	12	30	53	35	88
2009	67	66	11	31	56	35	91
2010	64	65	8	30	56	35	91
2011	67	61	12	26	55	35	90
2012	66	57	10	22	56	35	91
Total	329	314	53	139	276	175	451

Recession. Different studies recommended studying corporate governance during economic turbulence (Al-Gamrh *et al.*, 2018; Hassan and Halbouni, 2013). Finally, the SCA reported a negative net foreign investment in the Emirati markets in 2008 which sporadically occurred after crisis.

4.2 Variable measurement and model specification

4.2.1 Dependent variables. Firm financial performance is measured using two proxies. ROA is calculated as net income before extraordinary items scaled by total assets and ROI as defined by Worldscope. On the other hand, firm social performance is measured based on the index developed by Al-Gamrh *et al.* (2018) that examines UAE firms along their social dimension. The index comprises four questions–whether the firm uses environment-friendly materials or has made any positive contribution to protect the environment; whether the company has any human or social development programs; whether the company is free of any penalties resulting from violations of any governance or securities law; and whether the firm has an internal audit system. The firm's annual reports, CSR and corporate governance reports and other market reports were screened to answer our four questions in the index. The answer to each question is binary, equaling 1 if the company meets the criteria and 0 otherwise. After reading the firm's reports, for the first question, the firm scores 1 if it contributed in any way to protect the environment. For example,

> Our IT department donates old and outdated electronic equipment for recycling. This prevents the leakage of harmful toxic materials into the environment. DSI's active recycling methods have been lauded and acknowledged by the Environserve which lauded the company for recycling 104 pieces of IT equipment weighing nearly 900 kilos. These ranged from computers, monitors, printers and laptops (Drake and Scull, 2012 CG report, p. 34)

For the second question, it was scored 1 if the firm has any social development activities. For example,

> The company sponsored several community development activities such as Dubai women marathon, world diving championship 2012, Dubai tennis championship . . . (Dubai refreshments CG report 2012, p. 9)

For the third question, it was verified if the firm has an internal audit unit. For the last question, the firm scored 1 if it did not pay any fines to the SCA during the year. The index is the sum of the four questions and thus ranges from 0 to 4. A higher index value indicates greater social performance.

4.2.2 Independent and control variables. Foreign ownership is measured by the percentage of shares held by foreign investors to total shares issued by the firm. Arab and non-Arab ownership are measured using the percentage of shares held by each investors' identity group. We used the stock markets' classification of Arab and non-Arab investors. They classify Arab investors as the investors whom nationality from any of the 22 Arab League countries. Board independence is measured by a dummy variable that assumes a value of 1 if at least one-third of the board comprises independent members.

In addition, we control for the size of the firm, leverage and institutional ownership. Firm size is measured as the log of market capitalization, institutional ownership as the percentage of shares held by national institutions and leverage as total debt scaled by total assets.

4.3 Regression models

To achieve the objectives of this study, we employed several different regression models. First, we run a basic regression specification to test the influence of foreign ownership on firm financial and social performance. In the second stage, we include interaction terms between board independence and foreign ownership to identify the role of board independence in the relationship. Finally, we segregate foreign ownership into Arab and non-Arab and regress them as well as their interactions with board independence on firm financial and social performance in model 3 and 4. The four regression models are outlined as follows:

$$\begin{aligned}\mathrm{Perf}_{it} &= \beta_0 + \beta_1\,\mathrm{INSOWN}_{it} + \beta_2\,\mathrm{LVRG}_{it} + +\beta_3\,\mathrm{SIZE}_{it} + \beta_4\,\mathrm{INDP} + \beta_5\mathrm{FOWN}_{it} \\ &\quad + \text{Year dummies} + \varepsilon_{it}\end{aligned} \tag{1}$$

$$\begin{aligned}\mathrm{Perf}_{it} &= \beta_0 + \beta_1\,\mathrm{INSOWN}_{it} + \beta_2\,\mathrm{LVRG}_{it} + +\beta_3\,\mathrm{SIZE}_{it} + \beta_4\,\mathrm{INDP} + \beta_5\,\mathrm{FOWN}_{it} \\ &\quad + \beta_6(\mathrm{FOWN}\times\mathrm{INDP})_{it} + \text{Year dummies} + \varepsilon_{it}\end{aligned} \tag{2}$$

$$\begin{aligned}\mathrm{Perf}_{\mathrm{it}} &= \beta_0 + \beta_1\,\mathrm{INSOWN}_{it} + \beta_2\,\mathrm{LVRG}_{it} + +\beta_3\,\mathrm{SIZE}_{it} + \beta_4\,\mathrm{INDP} + \beta_5\,\mathrm{ARAB}_{it} \\ &\quad + \beta_6\,\mathrm{NONARB}_{it} + \text{Year dummies} + \varepsilon_{it}\end{aligned} \tag{3}$$

$$\begin{aligned}\mathrm{Perf}_{it} &= \beta_0 + \beta_1\,\mathrm{INSOWN}_{it} + \beta_2\,\mathrm{LVRG}_{it} + +\beta_3\,\mathrm{SIZE}_{it} + \beta_4\,\mathrm{INDP} + \beta_5\,\mathrm{ARAB}_{it} \\ &\quad + \beta_6\,\mathrm{NONARB}_{it} + \beta_7(\mathrm{ARAB}\times\mathrm{INDP})_{it} + \beta_8(\mathrm{NONARB}\times\mathrm{INDP})_{it} \\ &\quad + \text{Yeardummies} + \varepsilon_{it}\end{aligned} \tag{4}$$

Where,

For each firm (i) and each year (t)

Perf = Denotes ROA/ROI/Social performance index

LVRG = Total debt/total assets

FOWN = Percentage of foreign ownership

ARAB = Percentage of shares held by Arab investors

NONARB = Percentage of shares held by non-Arab investors

INSOWN = Percentage of institutional ownership

SIZE = The natural logarithm of market capitalization

Years = Dummy variables for years (year fixed-effects)

ε = Error term

We started with the application of the Hausman test to our models, only to find that the fixed-effects specification is most appropriate for our dataset. However, diagnostic tests confirmed the presence of heteroscedasticity, autocorrelation and cross-sectional dependence in our data. To correct for that, this study uses Driscoll and Kraay's standard errors based on (Hoechle, 2007)), which are robust to all the three–heteroscedasticity, autocorrelation and cross-sectional dependence. The adjusted Driscoll and Kraay's standard errors represent a nonparametric covariance matrix that estimate a fixed-effect model and apply equally well to unbalanced panel data.

5. Empirical results

5.1 Descriptive statistics

Descriptive statistics of the variables are reported in Table 2. As mentioned earlier, our dataset represents an unbalanced panel comprising 451 firm-year observations for the period 2008–2012. From Table 2, we can see that for our measures of firm financial performance, mean ROA is 2.24% and mean ROI, 5.38%. Social performance index has a mean of 1.02, indicating that there only about 25.5% of firms met all the four conditions of our index.

The percentage of foreign ownership (FOWN) ranges between 0 and 66.9% with a mean of 9.3%. Foreign ownership consists of Arab investors with a maximum of 66.9% and non-Arab investors with a maximum of 32%. The mean of Arab and non-Arab investors' holding is 11.4 and 5.9% respectively.

We also see that in general, the UAE firms in our sample have a high degree of institutional ownership. The percentage of institutional ownership (INSOWN) varies from 0 to 99.96%, with a mean value of 41.3%. Table 3 presents detailed statistics relating to the construction of the social index (Al-Gamrh *et al.*, 2018). It also highlights the distribution of sample firms across the four criteria laid down by the index.

5.2 Correlation analysis

Table 4 presents the correlation matrix for our key variables and offers some rich insights. We can see the high correlation coefficient between ROA and ROI (0.907). This is to be expected since they capture the same phenomenon – the financial performance of the firm. We also note a negative and significant relationship between foreign ownership in the firm and both ROA and ROI. Similarly, leverage is related negatively to both metrics of financial performance, ROA and ROI. It is not surprising to find a strong, positive correlation between board independence and our social index. This is consistent with our hypothesis about board independence and CSR effort.

We also find a significant and negative relationship between foreign and institutional ownership. This is not surprising, since both may be substituting each other as mechanisms of corporate governance. We similarly observe a negative (and significant) correlation between board independence and institutional holdings in the firm. We attribute this too, to the substitutive nature of both mechanisms of alternate corporate governance.

	N	Mean	SD	Min	Max
Independence	451	0.572	0.495	0	1
Non-Arab	451	0.0295	0.0594	0	0.320
Arab	451	0.0637	0.114	0	0.669
ROA	451	2.243	7.096	−37.59	29.18
Firm size	451	6.080	0.664	4.350	7.929
Leverage	451	15.31	17.45	0	78.64
Foreign	451	0.0927	0.139	0	0.669
Institutional	451	0.413	0.258	0	0.99
ROI	451	5.381	10.71	−68.45	45.10
Social	450	1.020	1.357	0	4

Note(s): The sample for this regression comprises 451 firm-year observations, representing listed firms on the ADX and DFM over the period 2008–2012, for which data are available. Independence is a dummy that equals 1 if at least one-third of the board of directors are independent members. Non-Arab and Arab are the percentage of shares owned by non-Arab and Arab investors, respectively. Foreign is the percentage of shares held by all foreign investors collectively. Firm size is the natural log of market capitalization of the firm; Leverage is total debt scaled by total assets; Institutional is the percentage of shares held by local institutional investors; ROA and ROI are proxies of financial performance and Social is the social performance index based on Al-Gamrh *et al.* (2018)

Table 2.
Descriptive statistics

Table 3.
Social performance statistics

Social performance (total)		25.5 %
(1) Does the firm use environment-friendly materials or have any positive contributions to save environment? (It was verified if the firm contributed in any ways to protect the environment)	113	25.1%
(2) Does the firm have any human and social development programs? (It was verified if the firm has any social development activities)	56	12.4%
(3) Is there an internal audit system taking place in the company? (It was verified if the firm has an internal audit unit)	175	38.9%
(4) Is the company free of any SCA penalties and/or fining for governance malpractices or other securities law violations during the last year? (It was verified if the company did not pay any fine to the SCA in the year)	115	25.6%

6. Results and discussions

Firms with high foreign ownership are believed to have better opportunities since they have superior utilizable capabilities compared to domestic firms and therefore, their involvement in ownership is expected to boost firm performance. We, however, fail to find support for our hypothesis, as can be seen in Table 5 and Table 6. Thus, H1a is not supported using both regression specifications. Using two metrics of financial performance—ROA and ROI, we find no statistical significance on the relationship between foreign ownership and firm financial performance.

The argument we start with in the paper is that foreign ownership enhances firm performance by bringing in more production techniques and sophisticated management (Buckley and Casson, 1976, 2003; Dunning, 1988; Porter, 2011). However, one could say that foreign ownership in the UAE is not concentrated enough to make a change that can potentially affect performance.

In this regard, Choi and Hasan (2005) indicate that it is not simply the presence of foreign ownership that can significantly influence the performance of Korean firms, but rather a high enough level of foreign ownership. Along the same line, Chhibber and Majumdar (1999) find that only when foreign investors are armed with proper authority and hold at least 50% of the firm's ownership are able to influence firm performance positively.

Further, it is doubtful that foreign investors can have total economic freedom to run firms in developing countries based on their agenda. Aslund and Boone (2002) and Shleifer and Vishny (1997) argue that corruption and high bureaucracy in developing economies could prevent foreign investors from influencing firms to their full potential. While domestic investors could better protect their rights using local connections, several techniques can in fact be used against the interest of foreign investors, such as losing voting records or declaring their shares illegal (Zheka, 2005).

Model 2 of Tables 5 and 6 demonstrates the role of board independence in influencing the impact of foreign ownership on firm performance. Results show that in the presence of a highly independent board, foreign ownership negatively influences firm performance. Previous studies have documented inconsistent results of the impact of board independence on firm performance. R. Haniffa and Hudaib (2006) argue that independent board members in emerging markets are used to legitimize the activities of the business rather than monitoring management activities. We explain our results from different perspectives.

On the one hand, this result could indicate potential conflicts of interest or differences in opinion of independent members of the board and foreign investors. For instance, the primary objective of foreign investors could be the generation of short-term gains, while independent board members may care more about long-term sustainability and gains. In this way, the monitoring decisions of independent boards might go against short-term gains, which could potentially disturb profitability.

Table 4.
Correlation matrix

	ROA	ROI	Social	Foreign	INDP	Arab	Non-Arab	Instit	Size	Levg
ROA	1									
ROI	0.907**	1								
Social	0.027	−0.027	1							
Foreign	−0.129**	−0.104*	−0.062	1						
INDP	−0.019	−0.123**	0.517**	−0.071	1					
Arab	−0.089	−0.089	−0.029	0.896**	−0.027	1				
Non-Arab	−0.169**	−0.101*	−0.096*	0.628**	−0.133**	0.265**	1			
Instit	−0.005	0.006	−0.035	−0.377**	−0.132**	−0.326**	−0.249**	1		
Size	0.106*	0.191**	−0.132**	0.069	−0.311**	0.024	0.125**	0.156**	1	
Levg	−0.150**	−0.116*	0.048	0.138**	0.082	0.101*	0.164**	0.0507	0.163**	1

Note(s): The sample for this regression comprises 451 firm-year observations, representing listed firms on the ADX and DFM over the period 2008–2012, for which data is available. **Correlation is significant at the 0.01 level. *Correlation is significant at 0.05 level

	(1)	(2)	(3)	(4)
Institutional	0.059**	0.059**	0.050	0.056*
	(1.991)	(2.005)	(1.602)	(1.901)
Firm size	2.452**	2.443**	2.670**	2.946**
	(2.006)	(2.006)	(2.131)	(2.036)
Leverage	−0.238***	−0.239***	−0.228***	−0.235***
	(−11.025)	(−11.049)	(−10.985)	(−11.312)
Independence	−0.148	0.197	−0.175	0.490
	(−0.614)	(0.764)	(−0.787)	(1.493)
Foreign	−0.114	−0.089		
	(−1.177)	(−0.913)		
Foreign * independence		−0.045***		
		(−4.564)		
Arab ownership			−15.900**	−18.487**
			(−2.074)	(−2.286)
Non-Arab ownership			−35.128**	−24.135
			(−2.349)	(−1.488)
Arab * independence				13.439***
				(4.376)
Non-Arab * independence				−41.320***
				(−3.345)
Constant	−9.497	−9.647	−9.911	−12.220
	(−1.147)	(−1.159)	(−1.131)	(−1.205)
Observations	451	451	451	451
Number of groups	91	91	91	91
Year FE	Yes	Yes	Yes	Yes

Note(s): The sample for this regression comprises 451 firm-year observations, representing listed firms on the ADX and DFM over the period 2008–2012, for which data are available. The dependent variable is a firm's financial performance as measured by its return on assets. The key explanatory variable of interest is Arab and Non-Arab ownership. Different regression specifications are used through the addition of interaction terms. All regressions use firm and year fixed-effects. The symbols ***, ** and * denote significance at the 1%, 5% and 10% level respectively

Table 5. The effect of foreign ownership on firm performance measured as ROA

Another explanation is that independent board members could be pursuing political objectives rather than the expected role of monitoring firm activities and generation of profit. This is not surprising since the majority of the board of directors in the UAE must be UAE nationals. In this manner, the influence of foreign investors in terms of their ability to generate short-term profits may be hindered by political decisions through different channels.

In Models 3 and 4, we further classify foreign ownership into Arab investors and non-Arab investors. Results show a negative and significant impact of both Arab and non-Arab ownership on firm performance. Inconsistent with expectations, both types of foreign ownership negatively influence firm performance. However, in terms of magnitude, the negative coefficient on non-Arab ownership is almost double the size of that on Arab ownership, suggesting that non-Arab ownership affects firm performance much more negatively.

Various studies have documented the negative influence of foreign ownership on firm performance (e.g. Bayrakdaroglu *et al.*, 2012; Praptiningsih, 2009). Phung and Le (2013) note similar results for firms in Vietnam and argue that foreign investors have lower ability to monitor firms in emerging markets as they are not concentrated and suffer from information asymmetry. This is qualitatively similar to UAE's environment since its policy restricts foreign investors from holding more than 49% in a company. This in turn deprives them of the power to control the company and bring about change.

	(1)	(2)	(3)	(4)
Institutional	0.060***	0.060***	0.054**	0.060***
	(2.860)	(2.896)	(2.401)	(2.811)
Firm size	3.771***	3.751***	3.877***	4.140***
	(4.424)	(4.287)	(4.400)	(3.516)
Leverage	−0.228***	−0.229***	−0.223***	−0.233***
	(−13.095)	(−12.458)	(−13.881)	(−14.345)
Board independence	−0.419	0.354	−0.435	0.697*
	(−1.567)	(1.184)	(−1.621)	(1.706)
Foreign ownership	0.027	0.084**		
	(0.795)	(2.503)		
Foreign * independence		−0.101***		
		(−7.642)		
Arab ownership			−8.258**	−7.475**
			(−2.036)	(−2.199)
Non-Arab ownership			−11.948	1.274
			(−0.896)	(0.086)
Arab * independence				8.701
				(1.526)
Non-Arab * independence				−50.967***
				(−3.457)
Constant	−15.193**	−15.527**	−14.637**	−17.077**
	(−2.401)	(−2.384)	(−2.227)	(−2.007)
Observations	451	451	451	451
Number of groups	91	91	91	91
Year FE	Yes	Yes	Yes	Yes

Note(s): The sample for this regression comprises 451 firm-year observations, representing listed firms on the ADX and DFM over the period 2008–2012, for which data are available. The dependent variable is a firm's financial performance as measured by its Return on Investment. The key explanatory variable of interest is Arab and Non-Arab ownership. Different regression specifications are used through the addition of interaction terms. All regressions use firm and year fixed-effects. The symbols ***, ** and * denote significance at the 1%, 5% and 10% level respectively

Table 6. The effect of foreign ownership on firm performance measured as ROI

The negative influence of Arab and non-Arab foreign ownership on firm performance holds for both ROA and ROI. However, the impact of board independence on this relationship is significantly different for the two types of foreign ownership identities. Results in column 4 indicate that even when Arab ownership affects firm performance negatively on an average, in the presence of a highly independent board, its negative influence on firm performance is significantly reduced. We attribute this result to better cultural understanding and similarity between Arab foreign investors and the Arab board members. Independent directors are believed to help avoid wealth expropriation by concentrated ownership and improve management decisions (Miller and Le Breton-Miller, 2006).

However, for non-Arab investors, in the presence of a highly independent board, the impact on firm performance is worse, than without. This could mean that in the presence of independent board members, non-Arab foreign investors who differ in their cultural characteristics, language and beliefs, may lose ground as also, their ability to influence positively, firm profitability. This might even cause the non-Arab foreign investors to dispose their shareholding and leave the country, owing to persistent friction with independent board members. Given the fact that board independence is one of the tools employed to monitor the operations of the firm and protect the interests of minority shareholders, countries with low investor protection might use corporate governance tools to enforce political agenda rather than economic gain or increase shareholders' wealth. Ali (1995) argues that Arab states being suspicious to foreign influences after the crises in the region.

Table 7 reports the results of regression analysis with firm social performance as the dependent variable. As expected, we find a strong, positive coefficient on board independence, indicating a positive impact of board independence on social performance of the firm.

Hypothesis 3a stated that firms with foreign ownership exhibit greater social performance. The estimated coefficients (β = 0.034, p < 0.01; β = 0.039, p < 0.01) for foreign ownership are positive and significant in Model 1 and 2 respectively, indicating that the higher levels of investment by foreign shareholders are related to enhanced social performance.

This result implies that UAE companies with more foreign involvement display greater social performance as proactive legitimacy strategy to satisfy foreign investors and to draw more foreign capital. The finding is consistent with prior research (e.g R. M. Haniffa and Cooke, 2005; Khan *et al.*, 2013; McGuinness *et al.*, 2017; Oh *et al.*, 2011; Sukumara, 2017) that suggests that foreign investors are more familiar with social issues and are thus more likely to exert pressure on domestic firms to adopt socially responsible practices to reduce uncertainty and risk in the long-term.

We expected in hypothesis 3b that, relative to their counterparts, firms with non-Arab foreign investors will display greater social performance. We find that the estimated coefficients for non-Arab foreign ownership are positive and significant (β = 7.375, p < 0.01;

Table 7.
The effect of foreign ownership on firm social performance

	(1)	(2)	(3)	(4)
Institutional	−0.021***	−0.021***	−0.020***	−0.018***
	(−3.486)	(−3.543)	(−3.703)	(−3.789)
Firm size	0.067	0.065	0.027	0.084
	(0.292)	(0.282)	(0.125)	(0.399)
Leverage	−0.006**	−0.006**	−0.008**	−0.009**
	(−2.211)	(−2.212)	(−2.485)	(−2.605)
Board independence	0.748***	0.815***	0.754***	0.828***
	(3.431)	(4.003)	(3.509)	(3.967)
Foreign ownership	0.034***	0.039***		
	(3.128)	(4.022)		
Foreign * independence		−0.009***		
		(−4.130)		
Arab foreign ownership			2.792	1.852
			(1.304)	(0.944)
Non-Arab ownership			7.375***	9.282***
			(3.961)	(4.677)
Arab * independence				3.271***
				(9.967)
Non-Arab * independence				−6.970***
				(−22.829)
Constant	0.029	−0.003	0.220	−0.230
	(0.022)	(−0.002)	(0.168)	(−0.172)
Observations	450	450	450	450
Number of groups	91	91	91	91
Year FE	Yes	Yes	Yes	Yes

Note(s): The sample for this regression comprises 450 firm-year observations, representing listed firms on the ADX and DFM over the period 2008–2012, for which data is available. The dependent variable is a firm's social performance as measured by the social performance index. The key explanatory variable of interest is Arab and Non-Arab ownership. Different regression specifications are used through the addition of interaction terms. All regressions use firm and year fixed-effects. The symbols ***, ** and * denote significance at the 1%, 5% and 10% level respectively

β = 9.282, p < 0.01) while the positive coefficients on Arab foreign ownership are not statistically significant. This supports our conjecture.

To the best of our knowledge, we are the first to document such differential impact of Arab and non-Arab ownership on social performance of the firm. This novel finding implies that non-Arab foreign investors in the UAE are likely to promote and embrace social activities as they have greater emphasis on CSR in their home countries. This is premised on the view that foreign investors are more likely to support CSR activities if they are from countries with a strong CSR culture (Dyck *et al.*, 2017). Furthermore, non-Arab foreign investors may refer to a company social performance as guide that can assist them in making investment decision due to the significant information asymmetry. Having made their investment based on CSR rating, non-Arab foreign shareholders may start place pressure on UAE managers to actively adopt CSR practices and improve their firms' social performance. Meutia *et al.* (2017) argued that the demand for disclosure of information about the CSR activities by investors in developing countries is not as strict as investors from developed nations.

Hypothesis 4 (a) predicts that board independence will impact the association between foreign investors holding and CSR performance. To test this conjecture, we interacted foreign ownership with board independence. As expected, we find a strong, positive coefficient on board independence, indicating a positive impact of board independence on social performance of the firm. This is consistent with prior studies that suggest independent directors may feel that advocating investments in CSR activities is the best way to increase the long-term sustainability of a firm (Ibrahim *et al.*, 2003; Jizi *et al.*, 2014), and thus independent directors are more likely to be committed to CSR (Freeman, 1984).

However, the estimated coefficient (β = −0.009, p < 0.01) for the interaction term is negatively significant. This result offers support for the overinvestment hypothesis that suggests that mangers are more inclined to overinvest in CSR opportunistically to gain media coverage and to build their own reputation as good social citizens. Those managers who are not closely monitored may abuse their power to obtain private benefits and not to promote high ethical standards. The existence of independent directors on the board, who are appointed by the managers, is less likely to curb overinvestment action of managers. The negative coefficient can be interpreted as board independence acts as substitutable mechanism for foreign ownership with regard to social performance. The result is in congruent with prior researchers who found board independence can adversely influence CSR performance (e.g.Hanniffa and Cook, 2005; Orti z-de-Mandojana, 2016).

In hypotheses 4b and c, we expected board independent to influence the impact of foreign ownership identities on social performance. The interaction of board independence with non-Arab and Arab foreign ownership were used to test our propositions. The estimated coefficient (β = −6.970, p < 0.01) for the interaction term between board independence and non-Arab foreign ownership is significantly negative while it is positive and significant for the interaction of board independence with Arab foreign ownership (β = 3.271, p < 0.01).

The negative sign on the interaction term between board independence and non-Arab foreign ownership reveals that when outside directors dominate the board the positive impact of non-Arab foreign ownership on social performance is negatively attenuated. One possible explanation might be most companies in UAE are dominated by family members who concentrate on increasing their wealth and keeping control of the firms. Therefore, more powerful family members are less likely to pay attention to the long-term sustainability of the firms and to respond to their obligations to society. Given that outside directors are usually elected by family members, it is expected that independent directors may collude with family members to hide potential CSR opportunities from non-Arab foreign investors or they may not exercise their power to ensure firms actively engage in CSR.

In contrast, the positive sign on the interaction term between board independence and Arab foreign ownership indicates that firms with high Arab foreign ownership and more independent boards display greater social performance. This result could be explained by Arab foreign investors' religion and familiarity with UAE business environment. Arab foreign investors might be aware of family members' powerful position in the UAE companies, and thus they may demand a right to have more representatives on board of directors to reduce the risk that family members abuse their power. One other explanation is that what is considered CSR activities for Arab investors might not be considered as such by non-Arab investors – such as religious activities support or Quran citing activities – which make the independent board members more understanding to Arab investors.

7. Further analysis

In the main results, we find that independent board members have a negative influence on firms with non-Arab foreign ownership and a positive influence on firms with Arab foreign ownership. We run our regressions again, but with domestic ownership instead. In Table 8, we find that board independent has a positive influence on the impact of domestic ownership on firm's financial and social performance. This validates our argument that independent board members do not get along with non-Arab foreign investors due to cultural, religious or political reasons.

8. Conclusion

This paper addresses two very important questions which link UAE's corporate governance changing arrangements and its rapid increase in foreign investment with firm performance.

Dependent variable	(1) ROA	(2) ROA	(3) ROI	(4) ROI	(5) Social	(6) Social
Institutional	0.059**	0.059**	0.060***	0.060***	−0.021***	−0.021***
	(1.991)	(2.005)	(2.860)	(2.896)	(–3.486)	(–3.543)
Size	2.452**	2.443**	3.771***	3.751***	0.067	0.065
	(2.006)	(2.006)	(4.424)	(4.287)	(0.292)	(0.282)
Leverage	−0.238***	−0.239***	−0.228***	−0.229***	−0.006**	−0.006**
	(−11.025)	(−11.049)	(−13.095)	(−12.458)	(−2.211)	(−2.212)
Domestic ownership	0.114	0.089	−0.027	−0.084**	−0.034***	−0.039***
	(1.177)	(0.913)	(−0.795)	(−2.503)	(−3.128)	(−4.022)
Domestic* independence		0.045***		0.101***		0.009***
		(4.564)		(7.642)		(4.130)
Independence	−0.148	−4.320***	−0.419	−9.749***	0.748***	−0.051
	(–0.614)	(–4.682)	(–1.567)	(–7.854)	(3.431)	(–0.134)
Constant	−20.924	−18.513	−12.513**	−7.121	3.412***	3.873***
	(−1.437)	(−1.315)	(−2.115)	(−1.223)	(3.423)	(3.754)
Observations	451	451	451	451	450	450
Number of groups	91	91	91	91	91	91
Year FE	Yes	Yes	Yes	Yes	Yes	Yes

Note(s): The sample for this regression comprises 450 firm-year observations, representing listed firms on the ADX and DFM over the period 2008–2012, for which data are available. The dependent variable is a firm's financial performance as measured by its ROA and ROI, and social performance, as measured by the social performance index. The key explanatory variable of interest is domestic ownership. Different regression specifications are used through the addition of interaction terms. All regressions use firm and year fixed-effects. The symbols ***, ** and * denote significance at the 1%, 5% and 10% level respectively

Table 8. The effect of domestic ownership on firm financial and social performance

First, has the recent support of more foreign investment led to an improvement in corporate financial and social performance? Second, has the presence of independent board members played a part in enhancing the financial and social performance of firms with foreign investors? Previous studies found inconsistent results with regard to foreign ownership-firm performance relationship and as a result some of these studies argue that only high percentage of foreign ownership that matter. Others found high information asymmetry impacts foreign ownership decision-making in emerging markets. We tickle the issue by examining the identities of the foreign investors. We classified foreign ownership in the UAE to ownership by Arab foreign investors and non-Arab foreign investors. We then examine the role of board independence in the relationship between these types of ownership and firm financial and social performance.

Although we found consistent result on the impact of Arab and non-Arab foreign investors on firm financial performance, results show different impact on the influence of board independence in the relationship. High independent boards positively influence the impact of Arab ownership and negatively influence the impact of non-Arab ownership on firm financial and social performance. Our finding has a practical implication for foreign investors that they should be aware of factors affecting firm performance such that of professional and personal attributes of independent directors when making decisions to invest in companies. Investors can be informed of the type of companies that contribute toward CSR and show better performance. The findings of this study also send a signal for policy makers to reexamine the factors that influence the appointment of independent directors. Future research may study other corporate governance mechanisms with foreign ownership in emerging markets. Future research can also examine deeper the role of board independence in the UAE.

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Further reading

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