



**The Impact of Corporate Governance on Major Shareholdings:
The Case of Saudi Arabia**

Ahmed Alqarni

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Abstract

The aim of this thesis is to examine whether the Corporate Governance (CG) structure in potential investee companies in Saudi Arabia has an impact on major shareholders choices of shares. Scholars argue that good CG practices provide investors with more confidence to invest their wealth in capital markets especially in developing countries (McKinsey, 2000). Saudi Arabia embraces unique cultural, economic, social, religious settings and is characterised with a prevalent presence of major shareholders in the capital market that is accompanied by allegedly weak legal settings, which was observed after the infamous collapse of the Saudi capital market in February 2006 (Ramady, 2010; Al-Nodel and Hussainey, 2010; Al-Matari, Al-Swidi and Fadzil, 2012).

In order to investigate the impact of corporate governance on major shareholdings in the Saudi capital market, a full review of the CG evolution in Saudi Arabia is presented and two sets of questions are identified to achieve the objectives of this thesis. To address the research questions, this thesis employs triangulation (i.e., mixed methods, quantitative and qualitative) and embraces agency theory as main theoretical framework. The quantitative assessment is performed using a panel data analysis of 97 non-financial listed companies in the Saudi capital market over the period from 2013 to 2017 (485 observations). The qualitative assessment is performed by conducting semi-structured interviews with fifteen participants of different categories of major shareholders within the Saudi capital market.

Overall, the regression analysis has shown that total major shareholdings have a significant negative relationship with CG score. Some interviewees expressed similar views toward such mechanisms as they are believed to be responsible for the limitation of their power over investee firms. The results of regression analysis to each category of major shareholders have revealed that the only categories that are significantly related to CG is wealthy families (negative) and wealthy individuals (positive), which is also supported by the findings of the qualitative assessment. The qualitative assessment of the rest of major shareholders categories have provided mixed results concerning CG preferences. Few interviewees believe that some parts of CG structure of investee firms play a role during the decision-making of their investments. On the other hand, most interviewees have revealed that CG in general is not taken into consideration when making investment decisions. This explains the insignificant relationship between CG and most categories of major shareholders revealed by the regression analysis.

Dedication

This work is dedicated to my mother and my son Jassir.

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All thanks and praises to Allah (God), Almighty, for giving me help, guide, strength, and determination to complete this thesis. The successful completion of this thesis has been a challenging journey and there have been many people whose support and encouragement I would like to acknowledge.

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List of Abbreviations

| | |
|-------|-------------------------------------------------------------|
| AIS | Automated Information System |
| BASIC | Behavioural Assessment Score for Investors and Corporations |
| BOE | Bureau of Experts |
| CA | Company Act |
| CEO | Chief Executive Officer |
| CG | Corporate Governance |
| CGC | Corporate Governance Code |
| CMA | Capital Market Authority |
| CML | Saudi Capital Market Law |
| ESIS | Electronic Securities and Information System |
| EU | European Union |
| GAZT | General Authority of Zakat and Tax |
| GCC | Gulf Cooperation Council |
| GDP | Gross Domestic Product |
| GO | Government Ownership |
| IFC | International Financial Corporation |
| IMF | International Monetary Fund |
| IPO | Initial Public Offering |
| MENA | Middle East and North Africa |
| MoCI | Saudi Ministry of Commerce and Investment |
| NEDs | Non-Executive Directors |
| OECD | The Organisation of Economic Co-operation and Development |
| ROA | Return on Assets |
| SAGIA | Saudi Arabian General Investment Authority |
| SAMA | Saudi Arabian Monetary Agency |
| SAR | Saudi Riyal |
| SOCPA | Saudi Organization for Certified Public Accountants |
| SSRC | Saudi Share Registration Company |
| UAE | United Arab Emirates |
| UK | United Kingdom |
| US | United States |
| VIF | Variance Inflation Factor |
| WTO | World Trade Organisation |

Chapter 1. Introduction

1.1 Preamble

Corporate Governance (CG) has been an attractive theme of research in the recent twenty years. Economic events and scandals, such as the breakdowns of Enron and WorldCom in the US, Royal Ahold and Parmalat Maxwell in Europe, and the Asian financial crisis were indeed a substantial motive toward the focus on various issues concerning CG (Pettigrew and McNulty, 1995; Melis, 2005; Adams, Hermalin and Weisbach, 2009). Such collapses have steered investors away and caused the loss of their confidence in capital markets, which eventually raised the prominence of well-developed structures of CG (Demirag and Solomon, 2003). The existence of improper practices such as the negligence of the role of Non-Executive Directors (NEDs) as in the case of Enron (Solomon, 2007) and the overshadowing role of Chief Executive Officer (CEO) that faded the role of institutional investors as in the case of Royal Ahold, have led to such scandals (Mallin, 2007).

As a result, CG has become the topic of many debates among scholars and professionals attempting to restore investors' confidence and improve firm performance (Mangunyi, 2011). This interest in CG, in both developed and developing markets, has incentivised continuous publication of books and research in the field of CG as well as to the development and implementation of numerous regulations and laws across markets. Therefore, the topic of CG has been established as a mean to avoid business collapses around the world (Dunne et al., 2003; Mallin, 2007). However, CG importance is not only deemed as a tool to prevent corporate failures but also to boost the level of accountability, business growth, lowering the possibility of financial failure and dropping the cost of debt (McGee, 2009; Claessens and Yurtoglu, 2013). Given this, it can be realised that one of the incentives of implementing proper CG practices is to attract investors and restore their confidence by promoting growth in markets and increase the accountability.

Recently, the relationship between major shareholders and CG has been the interest of many researchers. Ownership concentration is viewed as a controlling tool which may eliminate agency problems that could arise between managers and owners (Jensen and Meckling, 1976). In theory, researchers assume that increases in ownership concentration leads to effective monitoring. Therefore, major shareholders play an effective role in aligning the interests of

managers and owners (Shleifer and Vishny, 1986). Deriving from these theories, this research does not focus on the role of major shareholders in enhancing the control and monitoring role but instead proceeds toward examining the relationship between CG and major shareholders, and precisely on how CG practices of potential investee firms can have an impact on major shareholdings share choices in the Saudi capital market, which is deemed as one of the incentives of developing CG practices around the world.

The motivation for focusing on the impact of CG practices on investment choices of major shareholders is derived from the complications that financial crises have caused in regard to investors' confidence and finance sources of firms. To elaborate, these crises that are caused by poor CG practices, transparency and disclosure quality (Haniffa and Hudaib, 2006), could weaken firms' ability to find finance sources such as banks, which eventually could put such firms in a risky position of being incapable of paying their obligations. Additionally, finding alternative finance sources is important for the sake of firms' survival. In this case, gaining the trust of major shareholders, who are considered a finance source, would create an opportunity to expand the options of financing firms' projects (Bernanke, 1983, cited in Hawas, 2016). Therefore, this thesis concentrates on the impact of CG practices in attracting major investors.

Before investigating the main issue of this research thoroughly, it is important to provide a brief introduction to the CG theoretical definitions, which could help understanding the discussions raised throughout this thesis. Thus, the next section of this chapter will present an introduction to CG, and the following sections will fully explain the research aims, questions, and structure.

1.2 Introduction to Corporate Governance

1.2.1 Definitions

Many academics and scholars have presented various definitions of CG, where each person studies companies from a different angle, which had led to different perceptions of CG that has caused the inability to recognise a unified definition (Mallin, 2007). One possible explanation of these differences is that different countries adopt different CG practices based on variations in their social norms, culture, and history. Each market may feature distinct characteristics that

differentiate it from other markets (Arcot and Bruno, 2006). In general, CG definitions support the importance of shareholders to their respective firms, the importance of internal control structures, engagement of with the different stakeholders and firms' social role (Shleifer & Vishny, 1997; Cadbury, 1992; OECD, 1999).

It is argued that the definition of CG can be viewed by two key perceptions: the narrow perception and the broad perception. The narrow perception of CG is usually limited to the matters related to investors' protection, management monitor and control, and other concerns linked to the problem of the agency theory (Olayiwola, 2010). This perception views CG as a tool used to ease problems caused by the separation of ownership and management in large companies (Tricker and Tricker, 2012). Researchers who approve this perception define CG as a collection of standards that intend to align the interests of shareholders and management (Johansson, Cheema and Mir, 2009). In contrast, the broad perception of CG leans toward the stakeholders' theory (Lin, Li and Bu, 2015). Supporters of this perception claim that CG is supposed to concentrate on handling the relationship between the different stakeholders of a company, including shareholders, creditors, debtors, customers and employees (Tirole, 2001). Based on this school of thought, CG is generally seen as a collection of rules and regulations that manage the relationship between a firm and its stakeholders (Becht, Bolton and Roell, 2003). This section presents the most recognised definitions of CG and indicates which ones are embraced by this research

One prevalent definition of CG was presented by the Cadbury Report (1992). The Cadbury Report has made a fundamental contribution to the area of CG in the modern era. The main motive for issuing this report was the surrounding concerns around the level of investors' confidence in the quality of financial reporting and accountability (Weir and Laing, 2001). The definition established by the Cadbury Report (2014, p. 14) describes CG as 'the system by which companies are directed and controlled'. Sir Adrian Cadbury extends the discussion by stating that:

Corporate governance is concerned with holding the balance between economic and social goals and between individual and communal goals. The governance framework is there to encourage the efficient use of resources and equally to require accountability for the stewardship of those resources. The aim is to align as nearly as possible the interests of individuals, corporations and society. (Iskander and Chamlou, 2000, p. vi)

The focus of the Cadbury Report was on the absence of the accountability of managements, the lack of proper financial reporting, the presence of untrusted external auditors. The report also suggests a number of mechanisms that assists in solving such issues including management accountability. Likewise, Prowse (1998b) demonstrated similar perceptions that are related to management accountability to investors. It is argued that the Cadbury Report is somehow flawed in regard of management accountability to shareholders since there are other stakeholder groups who hold the management accountable for their interests as well.

Shleifer and Vishny (1997, p. 737) present a definition of CG as:

The ways in which suppliers of finance to corporations assure themselves of getting a return on their investment.

Their definition indicates that CG is fundamental to firms to guarantee a return on investments to shareholders. It also demonstrates the agency problem that arises as a result of the separation of ownership and control which leads to the necessity of proper CG practices (Epps and Cereola, 2008). In the same vein, La Porta et al. (2000) defines CG as:

A set of mechanisms through which outside investors protect themselves against expropriation by insiders.

They emphasise that CG is essentially needed to remedy the split between insider and outsider investors that leads to conflicts of distinct interests between major and small investors and expropriation. Though, they express their view based on the narrow perception of CG due to the fact their interest is concerned with only the return on capital providers investments with ignoring the interests of other stakeholder groups.

Additionally, The Organisation of Economic Co-operation and Development (OECD) conceptualises CG as: “a set of relationships between a company’s management, its board, its shareholders and other stakeholders, and provides the structure through which objectives of the company are set, and the means of attaining those objectives and monitoring performance determined” (OECD, 1999, p. 11). The CG view of the OECD supports directors’ responsibility toward the interests of their stakeholders (OECD, 2004), by stating that CG is:

..... procedures and processes according to which an organisation is directed and controlled. The corporate governance structure specifies the distribution of rights and responsibilities among the different participants

in the organisation such as the board, managers, shareholders and other stakeholders, and lays down the rules and procedures for decision-making.

The OECD reinforced the view that directors are held accountable to the outcomes of their planning, leadership, communicating with stakeholder, conflicts of interests and the entity management. The CG framework established by the OECD has provided interests of stakeholders with better emphasis. According to Oman (2001) and Solomon (2007), they argue that although markets across the world may be characterised with different cultural, social, legal and political norms, definitions of CG are ought to highlight the importance of shareholders and other stakeholders' interests for the reason that CG is deemed as a system that verifies and balances companies' insider and outsider parties.

On this basis, a number of CG characteristics are reflected such as: (1) managements act as agents of capital providers, (2) managements are responsible for controlling and monitoring their firms' operations, (3) managements accountability extends to their shareholders as well as other stakeholder groups, (4) Protecting investors interests and maximising firm's value is the duty of directors and managers. As a result, it is noted that firms' managements have a great deal of responsibilities that leads toward the idealist return on shareholders' investments. From the above review of CG definitions, this research employs the narrow perception of CG to investigate the impact that CG has on major shareholders investment decisions in Saudi Arabia.

1.3 Research Motivations

As mentioned earlier, financial crises that occurred globally, such as the crisis in the South East Asian capital market in 1997/1998, has been attributed to weak CG structures, transparency and disclosure quality (Haniffa and Hudaib, 2006). The collapses of major firms over the past twenty-five years, especially in developed markets, have also been linked to poor CG structures and practices (Hussainey and Al-Najjar, 2012; Ntim et al., 2012a). Consequently, such collapses have affected almost all developing and developed markets around the world (Dullien et al., 2010). For instance, a severe financial crisis may compel banks to lower their credit exposure, which eventually would affect their desire or ability to lend. In this case, finance sources of non-financial firms would diminish which could place such firms in a risky position of being unable to pay their obligations. Thus, finding other finance sources would be crucial for their survival (Bernanke, 1983, cited in Hawas, 2016). Hence, this thesis concentrates on

the impact of CG structure in Saudi non-financial firms on attracting major shareholders, who are considered as a finance source and a mean of increasing firm's shareholders base. Given this, the focus of this thesis will be on the Saudi capital market for a number of reasons.

To begin with, Saudi Arabia has specific institutional, economic, political and legal systems that are similar to some other developing countries in the MENA region (Piesse et al., 2012). However, the kingdom's institutional and legal characteristics are somehow different from many developing and developed countries. For instance, Sharia law is dominant across different aspects within the country (Hussainey and Al-Nodel, 2008; Safieddine, 2009; Judge, 2010). The constitution of Saudi Arabia is prominently based on Sharia which signify that many laws are originated from Islamic teachings (Al-Matari et al., 2012). This indicates that different sectors including business, economy, politics and law are influenced by Islamic principles (Abu-Tapanjeh, 2009; Kamla, 2009). In addition, the characteristics of Islamic governance, including accountability, fairness, morality, social responsibility and transparency, are believed to be originated from such Islamic values. Therefore, it would be interesting to investigate the CG experiment in Saudi Arabia (Lewis, 2005; Safieddine, 2009).

In addition, Saudi Arabia is uniquely characterised with distinctive cultural and social systems (Al-Twajjry et al., 2002; Haniffa and Hudaib, 2007; Alshehri and Solomon, 2012). To illustrate, businesses are extensively influenced by informal ties among families, tribes and individuals, which is a social norm that is greatly valued (Hussainey and Al-Nodel, 2008). According to Baydoun et al. (2013), a large proportion of firms' operation within the MENA region are controlled by wealthy families. Families tend to hire their own relatives which indicates that their selection criteria are based on their ties, loyalty and personal relationships rather than competence, experience and proper qualifications. Thus, internal governance standards might be negatively affected by such behaviour (Albassam, 2014).

Furthermore, the political system in Saudi Arabia is formed on monarchical rule. All three main fundamental structures, namely the executive, legislature and judiciary, are entirely dominated by the Saudi king (Al-Matari et al., 2012). Hussainey and Al-Nodel (2008) indicates that firms CG practices, such as appointment of board directors, are often affected by political linkage. They claim that political appointments are overshadowing in public firms, which may negatively affect boards composition and independence. This government interference may also weaken the effectiveness of CG practices that are implemented by authorities in the Saudi capital market.

According to Alsaeed (2006), Kamla and Roberts (2010) and Baydoun et al. (2013), the current literature indicates that the tendency in conducting studies related to CG within the MENA region, including Saudi Arabia, has been gradually increasing. The different social, religious and political systems that exist within this region has stimulated researchers to further explore CG issues in these countries. Therefore, such differences may have an impact on the effectiveness of CG structure and practices.

Moreover, the ownership structure in Saudi listed companies is highly concentrated (Baydoun et al., 2013). One of the implications of such structure is that the agency problem can be exacerbated due to limited distinction between agents and principals (Jensen and Meckling, 1976). Another implication of high ownership concentration is that owners of middle eastern corporations tend to appoint their relatives and friends as board members, which is destructive to board independence. According to the World Bank's Report on the Observance of Standards and Codes (ROSC), listed companies in the Saudi capital market are commonly controlled by governmental institutions and wealthy families (ROSC, 2009). Thus, poor CG is perceived to have serious implications on the investors' confidence and interests, which eventually negatively impact the attractiveness of investment in the Saudi capital market (Albassam, 2014). On the other hand, the reliability and effectiveness of capital markets can be reinforced by adopting good CG practices. As a result, firms with proper CG structure will operate more efficiently compared to poor governed firms, which enable them to attract potential investors, and in this situation firms will be able to gain an additional finance source for further expansions (e.g., McCahery et al., 2010; Hawas, 2016). Additionally, a survey by McKinsey (2000) revealed that many investors lean toward well-governed firms. This raises the question of whether investors take into consideration CG in their investment decisions, especially in emerging markets such as Saudi Arabia. There is a growing concern regarding the dearth of studies that investigate the relationship between CG and major investors within the Saudi context. Although there is heterogeneity in regard of beliefs, preference, and skills among major investors (Cronqvist and Fahlenbrach, 2009), most studies concerning the impact of CG on investment decisions of major shareholders, particularly in developed countries, have focused on institutional investors only and paid less attention to other categories of major investors (e.g., Chung and Zhang, 2011; Ferreira and Matos, 2008; Khurshed et al., 2011). Therefore, this thesis focuses on the impact of CG on the investment decisions of major shareholders in the Saudi capital market as well as investigating the CG preferences of different categories of major shareholders.

1.4 Research Aims and Questions

A great deal of existing and ongoing research can be found for CG and many topics related to it such as: board structure (Hermalin and Weisbach, 1991; Bathala and Rao, 1995; Beine et al., 2004; Donnelly and Mulcahy, 2008), compensation (Hartzell and Starks, 2003; Ozkan, 2007; Chalevas, 2011), equity (Gompers and Metrick, 2003; Cremers and Nair, 2005), institutional investors (Bennett et al., 2000; Dahlquist and Robertsson, 2001; Gompers and Metrick, 2001; Davis, 2002; Chung and Zhang, 2011), firm value (Lemmon and Lins, 2003; Bauer et al., 2004; Gupta et al., 2009; Ammann et al., 2011; Black et al., 2011), and firm performance (Aggarwal and Knoeber, 1996, Bhagat and Black, 2002; Bhagat and Bolton, 2008; Anderson and Gupta, 2009; Bauer et al., 2010). However, less attention has been paid to the interests of different classes of major shareholders regarding CG practices, especially in Saudi Arabia.

In the Saudi context, studies have been focusing in a number of issues related to ‘institutional investors’ such as: their linkage to firm performance (Alhassan et al., 2015; Al-Sahafi et al., 2015; Abdallah and Ismail, 2017), impact on the CG system (Bukhari, 2014; Alakkas, 2016), and their relationship with corporate disclosures (Al-Bassam et al., 2015; Al-Janadi et al., 2016; Habbash, 2015; Razak and Zarie, 2015), but to the researcher knowledge there is no study has examined the impact of CG on investment choices of major investors and their different categories that exist substantially within the Saudi capital market. Therefore, this research aims to explain the relationship between CG and major shareholdings in the Saudi capital market as well as examining the aspects of CG that affect major shareholders choices of shares and attempts to go beyond the rhetorical answer that CG is important to major shareholders and explore their views of CG practices and their role as major investors in the capital market.

Thus, this research intends to answer seven questions to provide the current literature with further evidence on the impact that CG is perceived to have on choices of shares of major shareholdings in the Saudi capital market. The questions are explained as follows:

QUESTION ONE: WHAT IS THE EXTENT OF CG EVOLUTION IN SAUDI ARABIA?

This question attempts to shed light upon the history of CG developments in Saudi Arabia and pay more attention to the newly announced CG regulations in February 2017. Also, it aims to figure out the changes and implications of the new regulations as they are assumed to provide shareholders and boards with improved rights and more transparency. In addition, changes that took place during the period under investigation are also going to be analysed.

QUESTION TWO: WHAT ARE THE VIEWS OF MAJOR SHAREHOLDERS IN REGARD TO THE PERCEPTION, IMPORTANCE, AND COMPLIANCE OF CG?

This question attempts to explore the perceptions of major shareholders regarding their understanding of the meaning of CG and what definitions they can provide to be compared to literature. It also attempts to demonstrate their views of the and importance of CG and whether they grasp its necessity since the market crash in 2006. Additionally, the question investigates the level of compliance of their investee firms and the changes they experienced throughout the years since many provisions of the CG code have become mandatory.

QUESTION THREE: WHAT ARE THE VIEWS OF MAJOR SHAREHOLDERS TO DIFFERENT CG MECHANISMS IMPOSED ON LISTED COMPANIES?

This question investigates the perceptions of major shareholders regarding the CG mechanisms that are imposed on Saudi listed companies such as: board composition and independence, board size, board sub-committees, accumulative voting rights, and shareholders' rights. It attempts to demonstrate their evaluation of such mechanisms and whether they are considered favourable to their investee firms. It also evaluates their awareness of the purposes beyond CG mechanisms.

QUESTION FOUR: WHAT ARE THE VIEWS OF MAJOR SHAREHOLDERS IN REGARD TO THEIR ROLE IN THE SAUDI CAPITAL MARKET?

This question explores the views of major shareholders regarding their role and activism in the market. The outcomes of this question can provide an evidence of the extent of power of different categories of major shareholders in Saudi Arabia.

QUESTION FIVE: WHAT ARE THE VIEWS OF MAJOR SHAREHOLDERS IN REGARD OF THE IMPACT OF CG PRACTICES IN POTENTIAL INVESTEE COMPANIES ON THEIR INVESTMENT DECISIONS?

Answering this question would be useful for policy makers and firms, as major shareholders play a major role in share markets and own a high percentage of the Saudi Market. This would provide an evidence of what CG aspects attract investments to the market, besides of course other factors.

QUESTION SIX: WHAT CG MECHANISMS DO AFFECT SELECTION OF SHARES OF MAJOR SHAREHOLDERS?

This questions statistically examines the impact of CG structure in potential investee firms on the selection of shares of major shareholders. It illustrates what CG aspects attracts major shareholders in listed companies and whether the relationship is significant or not to contribute to the literature with an evidence of the perceived impact that CG has on investors.

QUESTION SEVEN: WHAT ARE THE PREFERENCES OF THE DIFFERENT CATEGORIES OF MAJOR SHAREHOLDERS IN CG MECHANISMS?

To answer this question, major shareholders are divided into categories based on the types that exist in the Saudi capital market. Each category preferences are examined statistically to provide an evidence of the different interests of such categories which is one of the contributions of this thesis. Table 1.1 presents the research aim, questions, and methods employed to obtain answers.

| Research Aim | Research Questions | Method |
|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------|-------------------------------------------|
| To explore the evolution of CG regulations in Saudi Arabia since the collapse and examine the impact of such regulations on major shareholders choices of shares in the Saudi capital market | Question one: What is the extent of CG evolution in Saudi Arabia? | Research Review |
| | Question two: What are the views of major shareholders regarding the perception, importance, and compliance of CG? | Semi-structured Interviews |
| | Question three: What are the views of major shareholders to different CG mechanisms imposed on listed companies? | Semi-structured Interviews |
| | Question four: What are the views of major shareholders regarding their role in the Saudi capital market? | Semi-structured Interviews |
| | Question five: What are the views of major shareholders in regard of the impact of CG practices in potential investee companies on their investment decisions? | Semi-structured Interviews |
| | Question six: What CG mechanisms do affect selection of shares of major shareholders? | Panel Data Analysis (Regression Analysis) |
| | Question seven: What are the preferences of the different categories of major shareholders in CG mechanisms? | Panel Data Analysis (Regression Analysis) |

Table 1.1: Research Aim, Questions and Methods

Source: constructed by the researcher

1.5 Research Structure

This research comprises of eight chapters for the purpose of examining the relationship between CG and major shareholders and how CG may affect their choices of shares in the Saudi capital market. The following is a brief outline of the structure of this thesis.

The first chapter is the 'Introduction' chapter. This chapter presents the overall background of the topic in the world. It demonstrates definitions of CG and its theoretical background. It also presents the motivations, aims, questions, and structure of the research.

Chapter Two is dedicated to the CG theories and models involved in this research. A full discussion of the agency and signalling theories are presented in this chapter. Additionally, a review of the CG models across markets is presented to comprehend the global settings across countries as well as the Saudi settings. Since the aim of this research is to investigate major shareholders preferences in CG, this chapter also presents a theoretical background of major shareholders and board quality.

In Chapter Three, a review of literature on CG practices will be presented and critically discussed. This chapter provides a detailed review of existing literature (internationally and in the Saudi context) of the role of major shareholders in capital markets. Also, as important, it provides a critique discussion of the literature published in relation to the relationship between CG mechanisms and major shareholders, in regard of their portfolio choices, and link them to the aims of this research in order to clarify contributions delivered by this thesis.

Chapter Four focuses on the local settings in the Saudi market and its different characteristics that are relevant to the discussions in this thesis. This chapter sheds light on the legal, political, economic, and social systems in Saudi Arabia as well as the emergence of the capital market. This chapter discusses the Saudi regulatory CG system as well as a full review of the history of the development of CG codes and major reforms over the years and provide readers with the state and trends of CG in Saudi Arabia for the period from 2006 and onward.

Chapter Five explains the methodology followed by this research. It presents details of research design including both inductive and deductive methods, empirical data collection, sample details, methods followed for analysis and any limitations arising. This chapter also defines and justify the different categories of major shareholders, use of variables (Dependant and Independent), control variables and the regression models. In addition, it presents the sources

of data used in the assessments in Chapter Six and Seven, and explains the steps followed for data collection and statistical methods used.

In Chapter Six, the findings of the descriptive statistics of the main models are reported in detail. This assists in understanding the trend of the data analysed. Results of regressions are discussed and compared to previous studies to shed light on the potential implications.

Chapter Seven deals with the assessment of the relationship between CG mechanisms and investment choices of different types of major shareholders from the agency perspective. Semi-structured interviews are analysed in this chapter and their outcomes are presented and discussed in order to answer the research questions. The last part of Chapter seven is dedicated to the discussion of integrated findings of both the quantitative and qualitative assessments undertaken by this research. It presents the similarities and dissimilarity among both results to portray a clear view of the current situation in Saudi Arabia in regard to the impact of CG practices on shares selection of major shareholders.

The last chapter of this thesis, which is the ‘Conclusion’, summarises the main findings and identifies the research strengths, contributions, and limitations in relation to CG research. It also presents recommendations for future research.

1.6 Conclusion

This chapter presented an introductory to the topic of this research. The background of CG concept and issues related to the core objectives of this research are briefly discussed. The chapter demonstrated the significance of this research as well as its aims, questions and structure that is ought to a contribution to the field of CG and major shareholdings.

The second chapter of the research will discuss the CG theories and models to provide a theoretical background of the aims of this research. It will evaluate the CG systems worldwide and in the Saudi context too.

Chapter 2. Corporate Governance Theories and Models

2.1 Introduction

This chapter discusses the main theoretical framework adopted in this thesis and demonstrates the recognised CG models globally as well as in Saudi Arabia. Owners of a firm appoint the board of directors who employ managers to oversee daily operations of their firm. Managers in publicly held companies are not deemed as owners, even though in some cases managers could own a small percentage of shares in their respective firms. This situation flags some questions in regard to how boards should work to protect the interests of owners, and how reliable they can be, especially in the matter of how financial statements reflect the actual financial position of the company. The role of board of directors in attracting investors and protecting shareholders' interests have been investigated largely in the CG literature based on different theoretical theories such as agency theory. Agency theory portrays that monitoring and controlling a firm's activities is the responsibility of the board of directors aiming to protect the interests of owners, including potential investors. Additionally, investors portfolio decisions are investigate based on signalling theory that captures the pattern that companies signal on their governance quality that is supposed to be useful during the decision-making process of investments.

Therefore, the theoretical arguments in this research are based on agency theory (Jensen and Meckling, 1976) and signalling theory (Spence, 1973) to investigate the relationship between CG structure in investee firms and major shareholdings and whether CG has an impact on investments decision-making process of major shareholders.

In addition, this chapter explores the different CG models across capital markets which are mainly the Anglo-Saxon model and the Continental European and Asian model. The CG model in Saudi Arabia is also examined in this chapter aiming to illustrate what differentiates it from CG models in other countries to better capture the Saudi context involved in this research.

2.2 Theories of Corporate Governance

2.2.1 Overview

Agency theory discusses the role of boards in supervising managers' actions and ensure their alignment with the interests of shareholders. The decisions of investors are investigated based on signalling theory which shows how the signalled quality of CG in a firm can intervene in the process of making investment decisions. The subsequent sections present a discussion on these theories.

2.2.2 Agency Theory

This section demonstrates different aspects of the agency theory, which is the main theoretical framework in this research, to show how CG structures could have an impact on the choices of shares of major shareholders. It also presents the reason for selecting the agency theory as the theoretical basis for the arguments in this research.

Agency theory discusses the relationship between shareholders and managers. In Jensen and Meckling (1976, p. 308), this relationship is defined as:

One or more persons (the principals) engage another person (the agent) to act on their behalf which involves delegating some decision-making authority to the agent.

Owners entrust power to the board of directors and managers to run the day-to-day activities in order to achieve the business goals (Abdullah and Valentine, 2009). As a result of this separation of ownership and management in a firm (Jensen and Meckling, 1976) and the separation between decision making and control actions (Ross, 1973; Fama and Jensen, 1983b), an agency conflict may arise which is called: principal-agent problem (Abdullah and Valentine, 2009).

The first study that announced concerns regarding the separation between ownership and management particularly in major firms was Berle and Means (1932). The authors argued that the occurrence of large firms will be accompanied by the need for employing professional managers to run such firms in the best interest of owners. This separation of ownership and

control became the prime issue discussed in agency theory by Fama and Jensen (1983b); and Cheffins and Bank (2009).

Berle and Means (1932) examined the ownership structure of the top 200 non-financial firms in the US to explain the separation of shareholdings and control in firms. Their findings indicated that the level of diffuseness of ownership in publicly held companies are much higher than other types of companies, which indicates that control is in fact in the hand of managers rather than owners. They continue by stating that:

Those who control the destinies of the typical modern corporation own so insignificantly a fraction of the company's stock that the returns from running the corporation profitably accrue to them in only a very minor degree. The stockholders, on the other hand, to whom the profits of the corporation go cannot be motivated by those profits to more efficient use of the property, since they have surrendered all disposition of it to those in control of the enterprise. (Berle and Means, 1932, p. 9).

According to Farooque (2007, p. 41), their viewpoint of the separation between ownership and management is based on three benchmarks namely:

- (1) Diffusion of ownership (where shareholders own insignificant amounts of shares)
- (2) The non-existence of manager holdings (or a small fraction of shares)
- (3) Separation of interests of owners and managers.

Berle and Means (1932) continues with regard to managers control by stating that control rights in firms are not linked with the ownership rather it is in the hand of managers. Although dispersed shareholders provide capital and claim residuals, they do not enjoy direct control of the business decisions made by managers, which may lead shareholders' interests to be neglected by managers.

In accordance with agency theory, agents are paid compensation and provided with incentives in order to work for the interests of their principals. In this case, the board of directors can be deemed as principals and managers as agents (see Figure 2.1). Agrawal and Knoeber (1996) adds to this by stating that there is another possible agency relationship where the board of directors can be regarded as the agent and the shareholders as the principal.

Jensen and Meckling (1976) argues that a company is basically a group of contracts between different parties such as: individuals, managers, investors, customers, suppliers, and creditors.

The existence of such relationships is usually costly. For example, in publicly held companies, the contract between the principal (the shareholders or the board) and the agent (managers) are based on that the agent is responsible for supervising the daily business operations on behalf of the principal. However, the interests of the principal and the agent may not be aligned together (Jensen and Meckling, 1976), which may cause the agency problem especially in the presence of information asymmetry (Coase, 1977). This situation may encourage managers to neglect their responsibilities and misuse the owners' investments (Jensen and Meckling, 1976; Shleifer and Vishny, 1997). Hence, the owners are supposed to be alert in regard of managers actions (Jensen and Meckling, 1976) and form a system that blocks any illegal or unethical actions by insiders.

Agency costs can be decreased by the principal through monitoring the actions of the agents and offering incentives to bring the interests of both parties together (Hall, 1998). In addition, a bonding situation may occur when managers actually come up with restrictions to their actions to ensure that the interests of the principal are not ignored. Furthermore, Farooque (2007) states that the formation of board sub-committees, such as audit and remuneration committees, can help the board monitoring role in avoiding the misconduct as well as introducing managerial equity ownership schemes that may lead to a stronger alignment of interests.

Moreover, in order to reduce agency cost, authorities may have an effective role by imposing regulations that fully explain the responsibilities and duties expected to be performed by boards and managers in eliminating any conflict of interest that may occur. For instance, a disclosure of specific information such as timely financial information can be enforced by law as well as imposing a penalty for non-compliance to help mitigating agency costs.

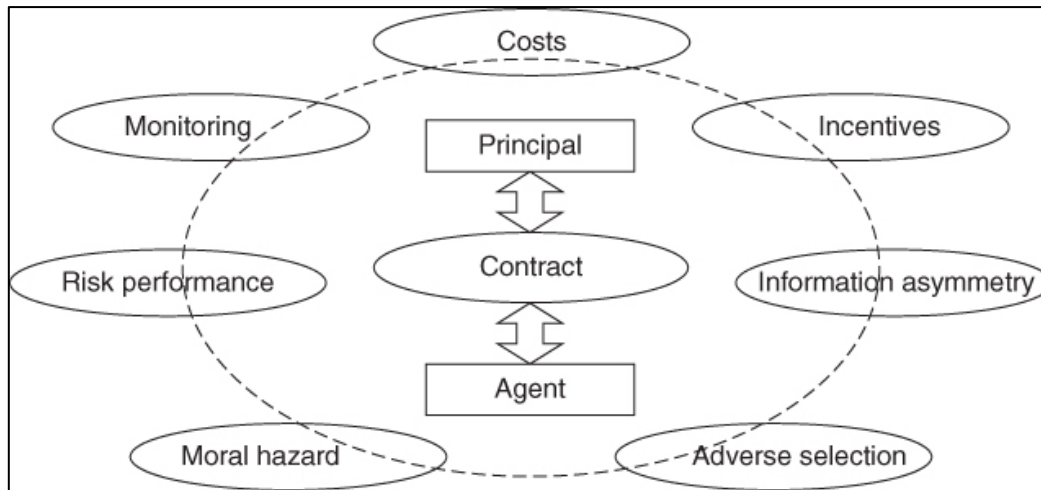


Figure 2.1: Issues in Agency Theory

Source: Murthy and Jack (2014)

2.2.3 *Information Asymmetry*

Information asymmetry between shareholders and managers is reflected by the agency problem. Payne, Berle and Means (1933) were first who presented the term ‘Information Asymmetry’ to describe the problem of the separation of ownership and control. Information asymmetry is mainly caused by the presence of the separation of ownership and control (Berle and Means, 1968; Jensen and Meckling, 1976; Fama and Jensen, 1983b) and the inadequate distribution of information between the owners and the management (Eisenhardt, 1989).

Akerlof (1970) contributed to the theory of information asymmetry through a case of the automobile market. In addition, Spence (1973) and Rothschild and Stiglitz (1976) further developed the theory on signalling via education in the labour markets and on imperfect information in insurance markets, respectively. Under a publicly held company, the management usually are better informed about the company and its position more than others outside the entity such as potential investors, which may cause reluctance in making investment decision by such investors. The issue of information asymmetry creates two major problems for investors namely: moral hazard and adverse selection which are caused by hidden information by management (Darrough and Stoughton, 1986).

The difference between the two problems is that adverse selection is caused by information hidden by managers before the event while moral hazard is linked to the actions taken by

managers after the event. Eisenhardt (1989) defines adverse selections as a twisting of facts by a manager. Additionally, Akerlof (1970) presents an example of adverse selection by stating that it is the same as the purchase of a used car as both the buyer and the seller have uneven information. In the context of stock markets, adverse selections occur when a firm does not disclose realistic information on its performance that enables the investor to make an adequate judgement of the firm's financial position comparing to other firms. Likewise, the case of Enron portrays an example of adverse selection where the weak performance was known to insiders but not disclosed satisfactorily in the financial statements (Arnold and De Lange, 2004). As a result, investors did not hold any information in the same level as managers did which eventually was disclosed after outsiders lost their investments.

Moral hazard can be explained as a situation that occurs when managers neglect to protect the interests of owners, which can be a consequence of either holding information away from owners or avoiding the performing of duties. This whole problem of information asymmetry and the relevant consequences of adverse selection and moral hazard can be eliminated by imposing effective monitoring by the board of directors; however, this monitoring can be costly (Cormier et al., 2010).

Based on the above discussion, it can be noted that agency theory is related to several problems with shareholders and managers. The agency relationship, which indicates that CG is structured to prevent agency problems, may suggest that major investors prefer to invest in companies with good CG structures. It can be argued that major investors/shareholders are the most affected by the consequences of the agency problem when their interests are not in line with agents' interests. Thus, major shareholders are motivated to invest in companies with good CG practices because it is alleged that such practices would assist in enhancing their investee firms' value (Gompers, Ishii and Metrick, 2003; Core, Guay and Rusticus, 2006; Brown and Caylor, 2006; Bebchuk et al., 2008). According to Shleifer and Vishny (1986), major shareholders can assist in elevating agency conflicts. For instance, based on the agency theory, major shareholders can assist in solving the free rider problem, which is expected to reduce agency costs and enhance the value of firms. Therefore, it is logical for major shareholders to select companies that are characterised with a good CG structure, which is an indicator of good performance, to enhance the performance of their portfolios (Chalevas, 2011). Hence, good CG can protect shareholders interests, which can be as important as financial performance of investee firms. Overall, the key motivation of major shareholders to invest in firms with good CG in the agency theory context is that good CG is deemed as an enhancement tool for a

company's performance and helps reducing risk that may have implications on the portfolio's value of major investors.

2.2.4 Signalling Theory

The signalling theory is adopted in this research to investigate the impact of CG on the decision-making process of investment of major investors. This theory suggests that a better performance could be signalled if a company has an active quality governance (Chiang and Chia, 2005), especially in relation to high returns and value (Bergh and Gibbons, 2011). Thus, this theory is mainly related to reducing information asymmetry (Spence, 2002). Signalling specific information to investors is the responsibility of management. For instance, the board and management quality serve as signals to potential investors during the decision-making process of their investments, which is consistent with the views of Zhang and Wiersema (2009).

Spence (1973) was first to introduce and develop the signalling theory aiming to describe the solution of asymmetric information in the job market. The study emphasises that employers usually do not hold complete information about job candidates and their actual qualifications. The presence of asymmetric information makes it tricky for employers to judge on the quality of candidates at the time of acceptance. Therefore, candidates are expected to inform employers of their qualifications and potentials, which forms a situation called the 'signalling function' (Stiglitz, 2000). In the context of CG, the literature has used such concept when the board of directors' actions are deemed to be signals of the quality of the firm and therefore alleviate the problem of information asymmetry for outsiders/potential investors (Zhang and Wiersema, 2009; Connelly et al., 2011).

The signalling theory is associated with two main matters in the capital market namely: (1) the gap of information that exists between different parties (Spence, 2002; Connelly et al., 2011), and (2) how the actions of one party are reflected by the behaviour of another party (Connelly et al., 2011). Moreover, scholars have applied the theory to describe the influence of signalling value of the characteristics of the board of directors (Certo, 2003), venture capitalists and angel investors, who are wealthy investors who helps establishing firms with their capitals (Elitzur and Gavius, 2003), and the diversity of the board of directors (Miller and Del Carmen Triana, 2009) (see Figure 2.2).

Finance studies show that some firms' characteristics have been regarded as signals of the quality and future scenarios of firms, for instance, firm's debt (Ross, 1973) and dividends (Bhattacharya, 1979; Benartzi, Michaely and Thaler, 1997; Mozes and Rapaccioli, 1998). If a firm is seen as having the ability to pay interest to bondholders and pay cash dividends to their owners, this situation is regarded as a signal of the quality and performance of the firm. A reduction in cash dividends may be regarded as a negative signal of the firm, however, this reduction may also indicate a positive signal for likely investors.

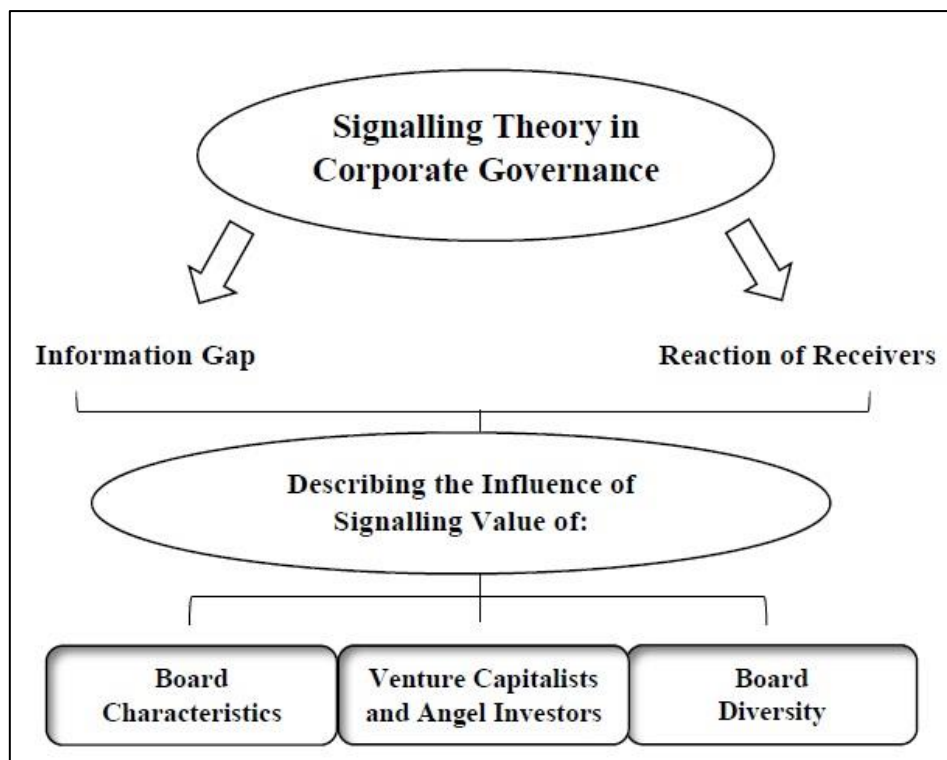


Figure 2.2: Issues in Signalling Theory

Source: Ochi (2015, p.105)

2.3 Models of Corporate Governance

This section of the chapter discusses the most recognised CG models across markets followed by a demonstration of the CG model in Saudi Arabia to comprehend the system that major shareholders deal with.

According to the OECD, CG frameworks across countries are not constructed on only one model of CG practices (OECD, 2004). The cultural and social patterns of each country form the model that is deemed suitable for their environment. Shleifer and Vishny (1997) argues that a good CG framework must involve legal protection and some extent of concentrated ownership. Besides, a good CG system has to direct management practices toward easing agency conflicts and attracting potential investors (Charkham, 2008; Shleifer and Vishny 1997).

Researchers have identified various models of CG practices around the world. There are two dominant models of CG practices that are formed on board structure, board composition, ownership structure, board activities, interests and duties of boards, legal systems, management, and shareholders. The models are: (i) the Anglo-Saxon model where ownership is dispersed and (ii) the Continental European and Asian (German–Japan) model where ownership is concentrated. The latter can be split into two slightly distinct models namely the German model and the Japanese model (see Figure 2.3). The subsequent sections discuss these models in detail.

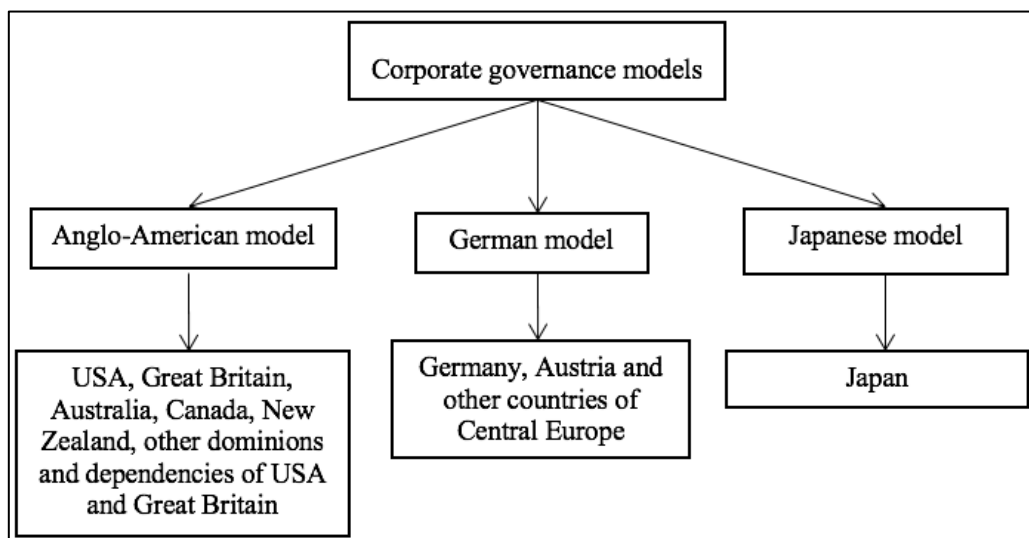


Figure 2.3: Models of Corporate Governance

Source: Zaynullin (2018)

2.3.1 The Anglo-Saxon Model

This model is broadly spotted in the US, UK, Canada, Australia, and New Zealand. The Anglo-Saxon model is often called the outsider module, one-tier system, market-based model, shareholder model, or the Anglo-American model. Strong legal protection and dispersed ownership are the primary characteristics of this model (La Porta et al., 1997, 1998, 2000; La Porta, Lopez-de-Silanes and Shleifer, 1999; Weimer and Pape, 1999). Countries that adopt the Anglo-Saxon model focus primarily on the protection of shareholders' interests. Therefore, it is claimed that the expropriation of small shareholders' interests and firms' resources in this model are averted (La Porta et al., 2000).

In the Anglo-Saxon model, the decision-making process of firms is unlikely to be influenced by the desire of individual shareholders (Keasey and Wright, 1993). This is caused by the approach that is broadly followed by management which is oriented toward the protection and increase of the interests of all shareholders categories (Weimer and Pape, 1999; Fisher and Lovell, 2003). In theory, conflicts between boards and shareholders are widely known as the agent- principal problem. In the Anglo-American CG model, such conflicts may arise when boards seek their own interests at the expense of shareholders' interests as indicated by Jensen and Meckling (1976).

One of the main features of this model is having a single tier board that consists of executive and non-executive (independent) members with a majority membership of the latter. This feature is deemed as a tool that restricts owners' membership on boards. Under this model, shareholders have the duty of selecting their board members who have the responsibility to choose managers to operate the firm. According to Aguilera (2005), this model consequently shapes a CG tripod with three main influencers precisely shareholders, management, and directors (see Figure 2.4).

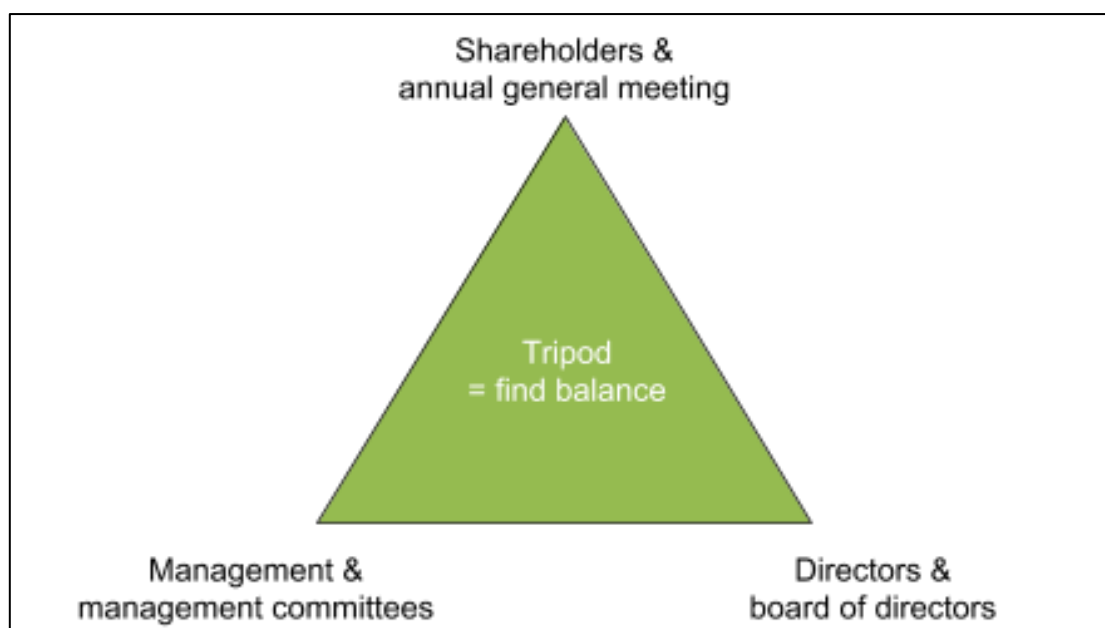


Figure 2.4: Main Influencers within the Anglo-Saxon Model

Source: Clarke (2007)

2.3.2 The Continental European And Asian (German–Japan) Model

The Continental European and Asian CG model is often referred to as a German-Japanese model, two-tier system, insider model, bank-based model, or stakeholder model. This CG model exists in civil law countries such as Germany, Japan, Italy, and France. Such countries follow this CG model which is characterised by a concentrated ownership structure and poor legal systems (La Porta et al., 1998, 2000; La Porta, Lopez-de-Silanes and Shleifer, 1999). As a result, major shareholders play a critical role in affecting the decisions of boards (Keasey and Wright, 1993). This model is very different from the outsider model (the Anglo-American) in that major shareholders such as banks, holding companies, non-financial firms and families are deemed important players within the insider model (OECD, 1999). They are often called insider shareholders due to their role and close relationship with the senior management. A Firm’s owners can even hold senior positions which is one of the dominant features of this model (OECD, 2003).

It is argued that the influence of this model is weaker on capital markets due to the fact that shareholders are only one part of firms’ stakeholders. This indicates that their interests are only considered in firms decision-making process, which is not the case under the umbrella of the Anglo-Saxon model (Monks and Minow, 2001). To illustrate, shareholders’ interests in the

Anglo-Saxon model are deemed as the core focus of the CG legal system whereas the German-Japanese model pays more attention to employees and the firm as a whole. The Continental European and Asian model can be divided into the German model and the Japanese model.

2.3.2.1 The German Model

There is a substantial difference between the German model of CG and the Anglo-Saxon model in regard of management, ownership structure, control practices, accounting, and legal practices. The German model, however, shares similar aspects with the Japanese model since it is argued that the Japanese Commercial Code of 1899 originated from German sources (Ungureanu, 2012; Kanda, 2015). According to Macdonald and Beattie (1993), under the German CG model, financial entities and corporations own large stakes in listed firms and have a leading impact on CG. Such corporations initiate coalitions with industrial groups for the purpose of influencing managers activities which leads individual investors to lose power (Cernat, 2004; Macdonald and Beattie, 1993; Ungureanu, 2012). The primary objective of this model is the success stability and continuity of the market.

The German system features a two-tier CG system where CG practices are carried out by two independent boards specifically the supervisory and management boards (Fohlin 2005). Both the management board and the supervisory board comprise of members who are employees of the firms. For instance, the management board comprises of executive managers whereas the supervisory board consists of representatives of shareholders and other employees of the firm (Macdonald and Beattie, 1993; Wójcik, 2003; Ungureanu, 2012). Both boards work separately, and no duality membership is allowed in both boards (see Figure 2.5). The role of the supervisory board is mainly to monitor the activities of the management board with the power to terminate it. The supervisory board is required to support the management board with a consulting service that provides recommendations related to the firm activities. In comparison with the Anglo-Saxon model, the supervisory board under the German model has the absolute power to make firm's decisions which is based on the influence of banks, insiders, and the external industrial network (Prigge, 1998).

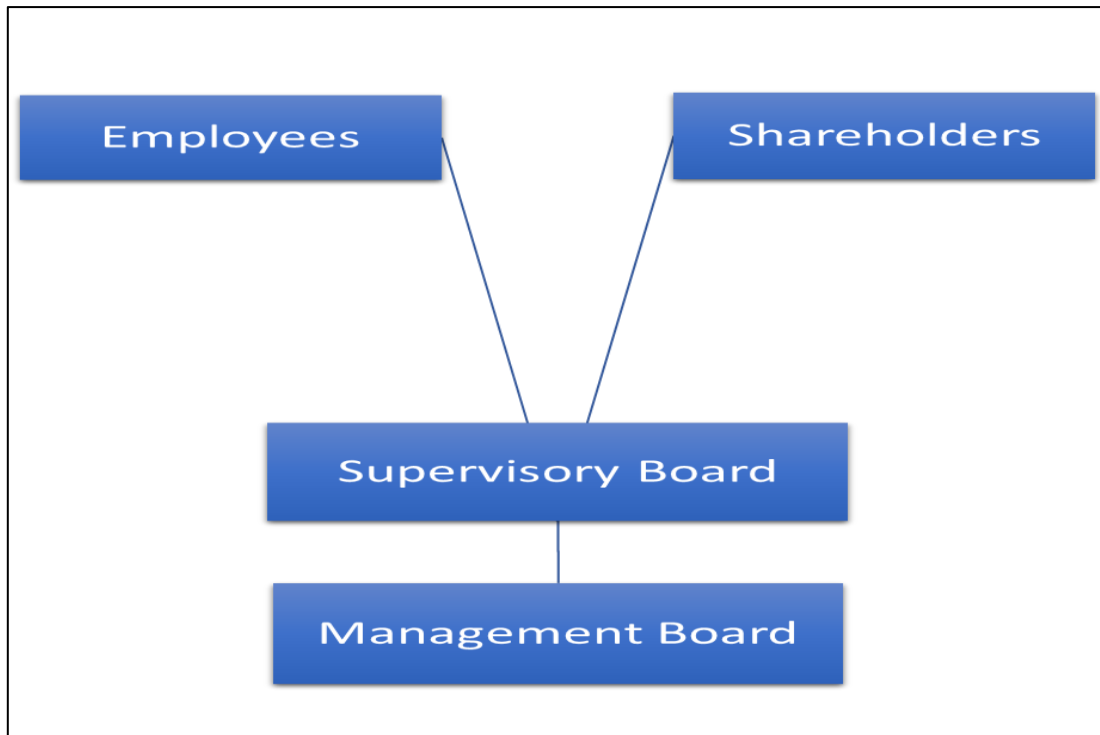


Figure 2.5: The German Corporate Governance Model

Source: Charkham (1995)

The management board, however, has the duties of the execution of day-to-day operations of the firm. Both banks and employees of the firm play a vital role in this CG model in comparison with the Anglo-American model, which is basically a market-based model. On the other hand, the disclosure regulations under the Anglo-American model used to be stricter than in the German model until the IFRS adoption by the European Union (EU) which causes this difference to lessen (Tariquzzaman, 2017). The German model requires firms to release financial statements every six months of their financial year, whereas in the Anglo-Saxon model financial reports are issued on a quarterly basis. Additionally, one of the main repercussions of CG framework in the German model is the weakened role it plays in the capital market due to the fact that banks have the power to form the CG framework (Mohiuddin, 2012).

2.3.2.2 The Japanese Model

In comparison to the German CG model, the Japanese model also features a concentrated ownership structure under the control of financial institutions such as banks and industrial

groups, that own 20% or more of a firm's voting rights (Gilson and Roe, 1993; Enriques and Volpin, 2007). To illustrate, industrial networks are usually suppliers or customers who deliver equity money to firms (Gilson and Roe, 1993). In the Japanese model, loans and equity capital, bond services, shares issues and consulting services are usually provided by banks. Consequently, banks gain the power and control of their investee firms. Thus, the impact of retail investors' role in the CG process is diminished since their holdings become insubstantial (Tariquzzaman, 2017).

In addition, the role of the Japanese government in the CG process is effective even though they hold no shares in some cases. The government in Japan has previously interfered with the CG structure in their market. For example, it has previously released instructions to merge firms to protect the main bank and hired retired governmental individuals to the board for this purpose (Gilson and Roe, 1993).

Under the Japanese CG model, there are five key players in the CG process namely: (i) banks as major shareholders, affiliated companies as shareholders, the state, the audit board, and the management. The board of directors in the Japanese CG model consists of insider shareholders and the management which is represented by the heads of departments. Banks appoint their representatives on boards of their investee firms and they also have the authority to appoint the board chairman. In comparison with the German model, listed firms are also obligated to appoint one or more independent members or a statutory auditor on their boards (Kanda, 2015). Additionally, the disclosure regulations in the Japanese are similar to the ones in the German model, which require companies to release financial reports every six months of their financial year compared with quarterly-based reports in the Anglo-American model. However, this issue is ought to diminish since the Japanese move to IFRS. (Tariquzzaman, 2017).

Finally, in the German-Japanese model, the agent-principal problem may occur due to a conflict in the interests of major and small shareholders. The agency problem can be sometimes referred to as the principal-principal problem (Shleifer and Vishny, 1997; Roe, 2008). This problem as mentioned earlier may arise when major shareholders exercise their power and control on boards to direct them to their own objectives with the disregard of the interests of minority shareholders, which can be seen occasionally when major shareholders instruct their investee and controlled companies to transfer cash and profits to their private accounts (Jiana and Wongb, 2004). Table 2.1 presents the characteristics of the Anglo-American and the German-Japanese models of CG.

| Trait | German-Japanese | Anglo-American |
|------------------------------------------------------|--------------------------------------------------------------------------------|--------------------------------------------------------------|
| Owners of firms | Insider shareholders | Outsider shareholders |
| Ownership structure | Concentrated | Dispersed |
| Cross-shareholding | Significant | Negligible |
| Separation of ownership and control | Little | Separated |
| Management | Usually two-tiered BoDs & the Supervisory Board | One tier, single BoDs |
| Control over management | Insider shareholders | Managers |
| Influence of Management | Weak | Strong |
| Agency problems | Rare | Exist |
| Hostile takeover activity | Rare | Frequent |
| Protection of investors | Weak in Company Law | Strong in Company Law |
| Shareholders' rights | Potential for abuse of power by majority shareholders | Potential for shareholder democracy |
| Shareholders voting | Majority of shareholders tend to have more 'voice' in their investee companies | Shareholders characterised more by 'exit' than by 'voice' |
| Requisition of wealth | Wealth transfer from minority shareholders to major shareholders | No transfer from minority shareholders to major shareholders |
| Legislation concerning with insolvency or bankruptcy | Strong protection of investors | Strong protection of investors |
| Accounting standards | Low | Severe |
| Transparency | Low | High |
| Market control of the firm | Negligible | Active |
| Managerial incentive | Negligible | Wide |

Table 2.1: Characteristics of the Anglo-American and the German-Japanese models of CG

Source: adapted from (Solomon, 2010) and Campbell and Jerzemowska (1999, cited in Ziolkowski, 2005).

2.3.3 Corporate Governance Model in Saudi Arabia

Regulators in the Saudi market evidently have been seeking regulations and standards to implement upon listed companies in the capital market aiming to ensure their compliance with good CG practices. As a result of such compliance, the interests of shareholders and stakeholders are protected (see Appendix G, Article 2a). The CG model adopted in the kingdom leans more toward the Anglo-Saxon model, which seeks the maximisation of shareholders wealth (Alshehri and Solomon, 2012; Seidl et al., 2013). This is originated from the fact that the Saudi corporate law was influenced by the British corporate law. For instance, the British Companies Act was the main source for the first version of the Saudi Companies Act of 1965 (Hussainey and Al-Nodel, 2008; Al-Matari et al., 2012). In the same vein, the first version of the Saudi CG code of 2006 was mainly constructed based on the UK Cadbury Report 1992 (Aguilera and Cuervo-Cazurra, 2009; Al-Abbas, 2009; Seidl et al., 2013). To illustrate, the CG

regulation in the kingdom adopt the model of a single-tier board consisting of executive and non-executive directors (NEDs) with no permission for a two-tier model to be adopted. In addition, the Saudi CG model is inconsistent with the German-Japanese CG model in regard to the presence of controlling banks or any other long-run controlling shareholders. Unlike the German-Japanese model, employees of Saudi listed companies have no role in relation to the business strategic objectives and decision-making process, and are not granted the option to be represented on boards neither.

In contrast, the legal system in Saudi Arabia along with CG regulations are believed to be originated from civil laws as seen in Germany and France (Sfeir, 1988). The Saudi legal system also consists of regulations that are set out for the protection of the interests of different stakeholders of listed companies, which is similar to the views of the German-Japanese model. To illustrate, the Chief Executive Officer (CEO) position has limited control to the business under the Saudi legal system. Additionally, the roles of the board chairman and CEO cannot be merged at all in Saudi companies (the Company Act, 2015, Article 81/1). In comparison with the Anglo-American model, contextual differences exist such as social norms and structure and concentrated ownership structure as the government plays a controlling role within the Saudi market. It dominantly holds shares in various sectors of the capital market such as services, financial, and labour sectors, which elevates the state impact over the market and obstructs the effectiveness of CG practices in the kingdom (Al-Twajjry et al., 2002; Haniffa and Hudaib, 2007; Hussainey and Al-Nodel, 2008; ROSC, 2009; Baydoun et al., 2013; Alamri, 2017).

Even though the Saudi CG model has similarities with both CG main models, it is argued that the firm's activities with different groups of stakeholders have somehow an impact on the structure of CG systems (Mallin, 2013). For instance, some characteristics of the German-Japanese model can be means of reforming the Saudi CG system. One of the characteristics that can be utilised to develop CG model in the kingdom is the role granted to employees in companies' strategic matters as they are not represented or facilitated with some sort of unions or civil institutions which protect their rights and interests.

Given this, the Saudi CG model seems to be shaped by the Anglo-American model in relation to CG regulations. However, some characteristics of the German-Japanese model are also adopted within the Saudi capital market such the ownership concentration as many listed firms are dominantly owned by major investors such as wealthy families and governmental

institutions. As a result, Saudi Arabia has encountered two main issues related to the adoption of the Anglo-American model; the comply or explain approach and the focus on shareholder approach rather than stakeholder.

The first issue refers to that listed firms are not obligated to implement all CG rules mirroring the ‘comply or explain’ approach applied in the UK. It is argued that even though this approach can be advantageous to firms in term of flexibility, this approach is believed to be inappropriate for the Saudi business environment. The main reason is the existence of concentrated ownership structure in Saudi firms compared to the dispersed ownership structure that exists in the UK (Hussainey and Al-Najjar, 2012). La Porta et al. (1999) indicate that controlling shareholders are not fond of good governance reforms, which can result in exploiting the interests of minority shareholders.

The second issue that is inherited from the adoption of Anglo-American model in the Saudi CG regulations is the shortcomings in the Saudi CA 1965 and CGC 2006 in relation to the protection of shareholders’ rights. Firms and practitioners may misinterpret shareholders’ rights because of their unclarity in laws. To illustrate, the code requires listed firms to adopt practices that manage their relationship with stakeholders; however, it does not provide guidelines in implementing such practice nor explain the identity of those stakeholders.

To sum up, the CG model in Saudi Arabia is tailored to the kingdom’s business environment, which is highly influenced by the US and UK practices (Al-angari, 2004). Therefore, it can be stated that the Saudi CG model is mainly constructed based on the Anglo-American model and its shareholder ordinated approach.

2.4 Major Shareholders

Before analysing the literature of the impact of CG on the choices of shares of major investors, it seems necessary to provide a demonstration of two main issues. First, since the research questions of this thesis focus on major shareholders views and preferences of CG practices, the theoretical background of ownership structure and major shareholders are discussed in detail. Second, the definitions, role, and incentives of common categories of major shareholders are discussed to demonstrate their importance and influence in capital markets, which has also motivated the accomplishment of this research.

2.4.1 Ownership Structure and Major Shareholders

One of the important aspects of the CG framework is ownership structure. Prior literature has focused largely on this issue since the release of Berle and Means (1932). According to La Porta et al. (1999), ownership definition leans toward voting rights rather than cash flow rights. They provide a categorisation of firms' ownership structure that consists of five distinct types namely: the government, family or individuals, financial firms, widely held firms, and other types of firms or investors. They argue that the issue of ownership structure is to some extent associated with the agency problem in two manners. The first manner appears when a firm's equity is dispersed among many shareholders and the dominant management has different objectives from those of shareholders. The second manner appears in the situation of concentrated ownership where few bodies such as the state or institutional investors hold controlling shares and affect the management decisions in their favour which causes the exploitation of the rights of minority shareholders. Therefore, protecting the rights of shareholders is an important issue that is linked often to firms' ownership structure. It is claimed that the authorities play a vital role in this situation by building a legal system that promotes the protection of shareholders' interests. According to Berle and Means (1932), the ownership and control roles are separated in developed markets, such as the US and UK, due to their legal systems that fully support the protection of minority shareholders (Mallin, 2007).

One of the motivating factors in enhancing the CG framework across markets is the protection of the rights of shareholders. According to the OECD principles, the CG framework is supposed to protect and allow shareholders to exercise their lawful rights (OECD, 2004, p. 18). In the same vein, legal systems across countries may differ in their structure and enforcement approaches. A classification of legal systems is presented by La Porta et al. (2008) who indicate that such systems fall into four approaches namely: common law in the UK, French civil law, the US and the British Commonwealth, German civil law, and finally Scandinavian civil law. The study finds that common laws are more associated with the protection of shareholders' interests. Additionally, it noted that the German and Scandinavian civil laws are more effective in protecting shareholders' interest than the French civil law. One of the characteristics of civil laws is that they implement alternative statutory practices in enhancing the protection of shareholders' interest such as mandating dividend distributions to investors.

In addition, it is found that to construct an effective CG framework, the legal system that guarantees the protection of shareholder's rights and the presence of some form of concentrated

ownership are deemed as crucial factors in this process (Shleifer and Vishny, 1997). It is claimed that major investors tend to concentrate on exercising specific rights such as voting rights in order to have an impact on their investee companies. In contrast, minority shareholders tend to demand protection against expropriation by major shareholders and directors of investee companies. In consistency with these findings, Solomon (2010) reveals that the presence of concentrated ownership grants major shareholders full access to information that may jeopardise the interests of minority shareholders whose ability to access such information may be limited.

In regard to the common types of shareholders that are represented by companies across capital markets, it is argued that different categories of major shareholders have their own preferences and motivations for purchasing shares in companies which determine their behaviour with companies (Denis and McConnell, 2003; Gugler et al., 2008). La Porta et al. (1999) examined the ownership structure of major corporations in 27 developed markets. The findings reveal that family-owned companies are dominant in such markets, who are also commonly present in other markets (Burkart et al., 2003; Mallin, 2007). The study also indicates that dispersed ownership structures tend to exist more in wealthy common law countries such as the UK, however, countries with ineffective practices of the protection of shareholders' interests are mostly characterised with concentrated ownership structure. According to Hart (1995b), institutional investors dominantly exist and have the ability to affect companies' practices. In the US, Gugler et al. (2008) states that US companies are also influenced by institutional investors. In Asia, specifically China, companies are mostly affected by the state blockholdings (Liu and Sun, 2005) while in Thailand family-owned companies are the most influential type of major investors along with some other Asian countries (Carney and Child, 2013; Wiwattanakantang, 1999, 2000, 2001). In addition, La Porta et al. (1999) has also found that, in many cases, the cash flow rights of such major and controlling shareholders are surpassed by their controlling rights, and other major shareholders such as financial firms seem to be passive in monitoring the practices of major shareholders such as families and the state.

Generally, in concentrated ownership, major shareholders have the ability and the control privilege that allow them to have an impact on their investee companies (Shleifer and Wolfenzon, 2002; Bava and Devalle, 2012b). Given this, definitions, role and incentives of common types of major shareholders including: (i) Family Ownership, (ii) Government Ownership, and (iii) Institutional Ownership are discussed in the subsequent sub-sections.

2.4.2 Family Ownership

There is no unified definition of family ownership because of the different objectives of prior studies. Gomez-Mejia et al. (2003), Haniffa and Cooke (2002) and Ghazali and Weetman (2006) state that the fraction of family members on boards determines the control level of families. Other researchers refer family ownership to a certain proportion of firms' equity owned by one family. Additionally, Anderson and Reeb (2003) indicate that the family ownership exists when a family holds at least 20% of a company's equity. In comparison, Prencipe et al. (2008) and Cascino et al. (2010) refer to family ownership when a dominant family holds 50% of direct and indirect equity in company.

In light of previous literature, the ownership of wealthy families is claimed to play a vital role in eliminating agency conflicts when they are closely attached to the control of investee firms (Bertrand et al., 2008; Fama and Jensen, 1983; James, 1999). James (1999) states that such companies tend to use their own financial resources to start their businesses, however, they seek external resources once they have expanded their business and ready for being publicly traded.

The presence of family-owned companies can have positive and negative aspects. In regard of the positive aspect, James (1999) claims that family-owned companies lean toward long-term investment, therefore, they dominate their firms for this reason. The relationship between family members is relatively strong even across different generations. Their loyalty and passion to each other strengthens their role as executives in their firms. Thus, family members as executives act in a beneficial way for the sake of the business and avoid any harmful activities that may have an impact on their interests. Furthermore, Smith and Amoako-Adu (1999) indicates that members of such families tend to be experienced and qualified in the essence of their businesses, which justifies their long-term relations with their directors, and transfer such quality to their family members. As a result, information asymmetry does not exist among family members and their managers which strengthen their monitoring role in the business.

Nevertheless, other researchers find that family-owned companies may motivate the occurrence of a different form of agency conflicts. To illustrate, Anderson and Reeb (2003) and Mishra et al. (2001) highlight that the manner that families follow in transferring business ties from one senior family member to a junior member is expected to reduce the company's

ability to attract outside qualified directors. Consequently, this ought to benefit the family at the expense of other categories of the company's investors (Mehrotra et al., 2013).

In addition, Fama and Jensen (1985) elaborate on the issue of diversification and exploitation linked to ownership structure. The study indicates that undiversified shareholders, such as family-owned companies, have a tendency to make investment decisions that neglects value maximising decisions. The interpretation of such tendency is that they may concentrate on the growth of their companies and the enhancement of their reputation and survival at the expense of value maximising approach (Anderson and Reeb, 2003). It is argued that such manner of family-owned companies may cause exploitation of minority shareholders by controlling such shareholders through different means such as underinvestment, dividend payments or tunnelling (DeAngelo and DeAngelo, 2000; Fama and Jensen, 1985; Mishra et al., 2001; Morck and Yeung, 2003; Shleifer and Vishny, 1997). Additionally, it is argued that the issue of exploitation may severely arise because of the attention paid by managers to the controlling family instead of other shareholders (Morck and Yeung, 2003).

2.4.3 Government Ownership

The definition of government ownership is also different among previous studies. The OECD (2011) refers government ownership to the magnitude of control that the government exercises via their holdings in companies whether they hold the entire number of shares or a proportion of them. The measurement of government ownership in Shen and Lin (2009) is based on the proportion of common shares owned by the government divided by total issued shares. Additionally, Cornett et al. (2010) and Wu et al. (2009) states that if at least 20% of a company's shares are held by the government, then government ownership exists.

Across many markets, it appears that many listed companies are partially or dominantly owned by the state. The incentives that push governments to invest in listed companies can be linked to political, social or economic objectives which aim to protect them from going bankrupt, support the enhancement of national industries, decreasing unemployment rate, avoiding inflation, support services sector (Capobianco and Christiansen, 2011; Chen, Firth and Xu, 2009; Cuervo and Villalonga, 2000). Therefore, their objectives seem to divert to some extent from profit maximisation and lean more toward social affairs (Sun et al., 2002; Downs, 1957; Shen and Lin, 2009). However, some government-controlled companies have the opportunity

to benefit from their government major shareholder in a number of issues such as tax exemptions and favourable interest rates especially those operating in social services sectors such as airports (Capobianco and Christiansen, 2011; Wiwattanakantang, 1999).

On the other hand, governments in some cases play their role as major shareholders competitively. For instance, extracting tax revenues can be a concern to the government as they are computed by company's profit. Therefore, the government may force managers to seek maximising firm value (Le and Buck, 2011). Besides, when the government experience deficits, they may also provoke managers attentions toward equity appreciation (Buck et al., 2008).

In a similar vein, Bös (1991, cited in Sun et al., 2002) argues that governments in a non-competitive market may behave differently from a perfectly competitive market. The study claims that the government tends to be committed in fulfilling their monitoring duties in non-competitive markets, which aims to focus on both profit maximisation and social welfare maximisation. However, the government monitoring role is likely to be passive in a perfectly competitive market which grants other shareholders the opportunity to play this role. According to Shen and Lin (2009), this can be interpreted as a mean to avoid monitoring costs that involve time and efforts, which exceeds political payoff.

2.4.4 Institutional Ownership

Davis (2001, p. xxiii) refers institutional investors to “specialised financial institutions which channel savings collectively on behalf of other investors to achieve a specific objective in terms of limited risk and maximum return”. Another definition of institutional ownership is presented by Celike and Isaksson (2013) who state that they are characterised by legal institutions which act in an independent manner or as a major group as seen in mutual funds. Ahmed and Duellman (2007) uses the proportion of common equity owned by such investors divided by total shares as a measure of institutional ownership. In comparison, Edwards and Hubbard (2000) uses a proportion of a company's outstanding shares purchased by the top five institutional shareholders as a measure of institutional ownership. However, Alfaraih et al. (2012) measures institutional ownership according to the percentage of shares owned by institutional investors that is equal to or exceeds 5% of the company's shares.

Previous research has exposed the role of institutional blockholders in supervising and guiding their investee firms toward their preferable objectives. Some studies revealed that the monitoring role played by institutional shareholders is motivated by factors such as the entity independence, the volume of their holdings and whether their investment is for the long-run or short-run in the business (Brickley et al., 1988; Chen et al., 2005; Cornett et al., 2007).

In addition, institutional shareholders tend to balance their monitoring role with the cost associated with it. Pound (1988) claims that such shareholders are likely to use their rightful votes to support directors whenever they have a business relationship with the company. The study argues that institutional shareholders support that type of directors in order to avoid any harmful action affecting their interests in the company. Accordingly, Chen et al. (2005) state that institutional shareholders can either lean toward monitoring or trading. When they are playing a monitoring and disciplining role, their trading role would probably be passive. They indicate that their net offset between costs and gains of monitoring and trading constructs their decision regarding the choice of role. This net off is mostly influenced by the size of their holdings and the length of their investment.

Furthermore, it is argued that institutional shareholders when they choose to play a monitoring role, they would earn financial gains and obtain the privilege of easier access to information since they have an impact on directors. Such gains rise as their holdings rise. Their monitoring costs are likely to decrease when they hold larger stakes or the duration of their investment becomes longer (Boonyawat, 2013).

2.5 Board Quality

A large body of literature have indicated that the quality of the board of directors is an influential factor in a firm success. Boards are considered to be a key element of the CG structure and have an important role to play in monitoring management (Fama and Jensen, 1983b; Baysinger and Butler, 1985; Adjaoud, Zeghal and Andaleeb, 2007; Adams, Hermalin and Weisbach, 2008). Researchers and various organisations have measured the quality of boards by using their characteristics in regard of their compositions and practices as well as financial performance and share price (Van den Berghe and Levrau, 2004).

Board quality has been defined more than once by the OECD based on characteristics of their composition. They have regarded the existence of a majority of independent directors, with

adequate qualifications and experience, as a crucial factor in measuring board quality (Kiel and Nicholson, 2003). In the Cadbury (1992) and Greenbury (1995) reports, an insistence has been made on the importance of this characteristic as a CG mechanism in defining board quality (ICAEW, 2016).

Hayes and Lee (1998) re-performed the model developed by Business Week in identifying board quality to explore the best and worst board qualities in US firms. The model is formed on scoring points for numerous directorships held by board members, existence of outsider director experience in the main business, past experience of members, attendance in board meetings, large board size and the duality of the CEO and chairman position. It showed that companies that scored high in board quality had only one executive member in their boards and compensations decisions were made independently. On the other hand, companies that has the lowest scores, such as Disney, had higher percentage of inside directors in the boards (Business Week, 2002). Additionally, having large boards were found to be unproductive in several studies since they lack proper coordination and adequate communications (Lipton and Lorsch, 1992).

In addition, De Andres, Azofra and Lopez (2005) examined the effect of board quality on firms' value in Western Europe and North America. They used almost the same characteristics that were already used in Business Week namely: board size, percentage of inside and outside members, annual number of board meetings, and board compensations. Several other studies also consider board independence as a critical indicator of board effectiveness in investigating the linkage between board effectiveness and company performance (Abidin, Kamal and Jusoff, 2009).

Holder-Webb and Sharma (2010) examined the reason and impact of the strength of CG on lender decisions in banks in Singapore. The strength of CG was determined by the percentage of independent board members, the qualification in finance and accounting, and the tie to related business and industry experience. They separated boards into two types namely: weak and strong. Their findings indicated that strong boards had a high percentage of independent members and sufficient knowledge in finance and accounting. Other studies have also focused on the independence of board members as a key element of board quality (El-Sayed, 2013; Li and Ang, 2000; Sharma, 2009).

Given this, it is evident that the literature of board quality was often measured by the characteristics of directors (Boeker, 1992; Daily, 1995; Li, 1997). They shared the focus on

similar indicators of board quality including independence, outside and inside directors, board meetings and board size. Considering prior studies, this research employs board quality as CG mechanisms in testing the impact of such characteristics on major shareholdings in listed companies the Saudi capital market.

2.6 Conclusion

This chapter addressed the CG theoretical framework employed to analyse views of relevant CG theories and models in relation to this research. The chapter was initiated by explaining two CG theories namely: Agency theory and Signalling Theory to help build the theoretical background of the research. A comparison of CG models is also presented to find similarities and differences of CG objectives around the world. The Saudi CG model seems to be influenced by both CG models which helps analysing the role of major shareholders in the Saudi capital market. In addition, a theoretical background of both major shareholders and board quality is presented since they are involved in the examinations of this research.

Chapter 3. Existing Research of The Relationship between Corporate Governance and Major Shareholders

3.1 Introduction

As discussed in Chapter One, this research intends to examine the relationship between CG and major shareholders in the Saudi capital market and investigate their preferences of CG in potential investee firms. Therefore, this chapter is devoted to review the current literature that examines this issue, and present various and recent empirical studies on CG relationship to major shareholders around the world. There are several motives for reviewing pervious research. First, it is insightful to obtain a general comprehension of CG and major shareholders issues on different grounds such as local legal settings, CG practices and models of the examined markets and the approaches employed to provide the literature with an evidence of the relationship nature. Second, this review helps revealing the outcomes that are achieved by the impact of CG practices on major shareholdings and the evidence that has been contributed to the literature. Third, it is expected to develop an evaluation of the Saudi CG system, which is somehow different from others in developed and developing countries as explained in Chapter Two. Fourth, this review is to present the arguments that involve CG and major shareholders relationship in order to understand its nature and implications as well as to show what gaps this research is attempting to fill. Finally, these inter-connected studies are supposed to provide the researcher with a proper guidance toward building the research methods model needed to answer the questions of this research which are concerned with examining the impact of CG structure of potential investee firms on the choices of shares of major investors as well as examining whether different categories of major investors prefer distinct CG elements and mechanisms.

This chapter is divided into four main sections: (i) the first section presents a theoretical background of the research issue based on the agency theory; (ii) the second section reviews the literature that has examined the relationship between CG and major shareholders with focusing on the impact of CG on the investment decisions of major shareholders; (iii) the third section presents the literature that investigated whether board quality attracts investors; and finally (iv) the literature in the Saudi context is discussed.

3.2 Theoretical Background

As discussed earlier, the importance of CG is elevated by conflicts of interest between shareholders and manager in firms, commonly known as agency problems. Conflicts of interest can be caused by two reasons. First, shareholders and managers may have different plans and goals. Second, information transmission between both parties is not always as perfect as one may hope. Berle and Means (1932) have suggested a separation of ownership and management accompanied by CG mechanisms to ease these conflicts. In this situation, no individual shareholder is motivated to monitor investee firm management because this individual shareholder may incur monitoring costs while the rest of shareholders take the advantage of such free monitoring. Hence, many researchers claim that major shareholders are the only category of shareholders that has the capability and motivation to bear monitoring costs (Shleifer and Vishny, 1986; Admati, Pfleiderer and Zechner, 1994; Huddart, 1993; Maug, 1998; Noe, 2002).

The role of major shareholders is an important component of CG and becoming significantly effective across markets. In fact, a great deal of literature has examined the role of major shareholders in enhancing firms' governance and reducing agency problems (e.g., Berle and Means, 1932; Fama and Jensen, 1983; Jensen and Meckling, 1976; Shleifer and Vishny, 1986). According to the agency theory in Jensen and Meckling (1976), ownership concentration is a control instrument that can be used to solve agency problems between managers and shareholders. The large ownership of major shareholders enables them to pressure managements toward different decisions and practices, as they are considered to be the owners of firms and have rights as well as duties (Gillan and Starks, 2007; Ferreira and Matos, 2008; Aggarwal et al., 2010; McCahery et al., 2010).

However, little literature has examined the effect that CG mechanisms on the investment behaviour of major shareholders. This research aims to provide evidence that assists in specifying the CG mechanisms preferences of major shareholders in their potential investee firms, and if the level of governance in these firms actually affects their investment decisions. Nowadays, major investors are a main influence in capital markets as they can be buyers, holders and sellers of securities which grants them power to affect capital markets (Al-Najjar, 2010). However, their CG preferences and activities are usually unrevealed and conducted

confidentially (McCahery et al., 2009). Thus, the existence and holdings volume of major shareholders is considered as a popular explanatory variable in the literature of CG.

3.3 The Relationship Between Corporate Governance and Major Shareholders

Many aspects of firms can attract major shareholders across capital markets. In general, companies apply multiple tactics to get the attention of more investors to their shares which can lead to increases in share prices and firm value. To illustrate, back in 2006 Ciena Corporation passed a reverse share split for the intention of having higher share price, which they hoped it would direct major shareholders interest toward their company (Chung and Zhang, 2011). In addition, it is reported by Williamson (1985) and Grossman and Hart (1986) that managerial opportunism negatively affects investors' desire to buy the firm shares. Gomper, Ishii and Metrick (2003) argue that firm value and stock returns tend to rise as a response to a good CG. Also, Chung, Elder and Kim (2010) reports that companies can have higher stock market liquidity if they were well-governed. Interestingly, Badrinath, Kale and Ryan (1996), Falkenstein (1996), and Huang (2009) confirm that major shareholders tend to tilt their portfolios toward shares with higher market liquidity and minor volatility. Other studies discuss the preference of institutional investors in firms with improved disclosures (Bushee and Noe, 2000), shares of large firms (Gompers and Metrick, 2001), shares of firms with better dividends distribution (Grinstein and Michaely, 2005), and share of firms that enjoy good managerial performance (Parrino, Sias and Starks, 2003). These are a part of many studies which investigated CG impact over companies, however, none of them has investigated the impact of CG over the shares selection of prospective major shareholders, and whether such shareholders consider CG structure of investee companies before they tilt their portfolio towards them, which is the objective of this research that focuses on this part of the relationship. The intention here is to investigate the literature that examined the impact of only CG structure of potential investee firms, as a perceived influential factor, on the selection of shares of major investors.

Generally, there are two broad approaches for investigating the relationship between CG and ownership structure. The first approach focuses on how ownership structure affects CG, including the effect of major shareholders. A large volume of literature has been dedicated to the advantages of major shareholders being a monitoring tool (Cornett et al., 2007) because it

is claimed that holding large stakes in a company is an important factor in firms monitoring process (Shleifer and Vishny, 1986). Over the years, major shareholders have used their ownership rights to effectively push firms to have good CG that assures the protection of shareholders' interests (Hartzell and Starks, 2003). For example, a number of studies indicated that the existence of institutional shareholdings in companies leads to better compensations practices (Bertrand and Mullainathan, 2001; Dong and Ozkan, 2008; Hartzell and Starks, 2003). Even though this approach is not followed in this research, a brief discussion seems useful to grasp the complete picture of the relationship between CG and major shareholders.

The second approach, which is followed by this research, focuses on the interests of major shareholders in CG, and how CG practices could have an impact on them. According to the Agency theory, the concentration of ownership of one of the control/monitoring tools that is utilised to ease agency conflicts that may arise between agents and principals. In theory, the increase in ownership concentration is accompanied with a more effective monitoring and more motivated major shareholders to be active in their monitoring and incentive in minimising agency conflicts (Shleifer and Vishny, 1986). The role of major shareholders, as demonstrated by Shleifer and Vishny (1986), is deemed as a key component of the agency conflict solution. Under the agency theory, major shareholders assist in mitigating the free rider problem which consequently serves as a way to reduce agency costs and enhance firm value. Since major shareholders' main objective is to maximise their capitals, CG mechanisms have been introduced to protect such capitals; therefore, investors generally lean towards investing in firms with better CG structures that would assure them acceptable performance (Chalevas, 2011), because if major shareholders invest in firms with poor governance, they would anticipate greater risk of not gaining reasonable returns (Chung and Zhang, 2011). Hence, firms are encouraged to investigate the CG preferences of major shareholders in order to expand their shareholders base and assist them to solve the agency problem.

In capital markets, major investors have an impact on capital markets globally via their dominance as buyers, holders, and sellers of securities (McCahery et al., 2010). Due to the large stakes they hold, they are expected to influence CG practices of firms. Hence, firms, policy makers, investors and researchers would need to be familiar of the CG preferences of major investors. In particular, researchers have often distinguished the CG preferences of institutional investors based on what seemed as crucial to such investors. For instance, prior studies have investigated the impact of governance changes, proxy voting, and monitoring by major investors on the market (see Pound (1988); Brickley, Lease and Smith (1988); Agarwal

and Mandelker (1993); Gillan and Starks (2000, 2007); Hartzell and Starks (2003); Gaspar, Massa and Matos (2005); Chen, Harford and Li (2007); Thomas and Cotter (2007); Renneboog and Szilagyi (2009); and Bushee, Carter and Gerakos (2007)).

Coombes and Watson (2000) have published the McKinsey survey which showed that 75% of institutional investors consider the board quality as important as the financial performance of firms. Useem et al. (1993) indicated that the US institutional investors prefer independent boards that consist of members with multi skills and experiences. In 2003, the UK 'Just Pensions' reported its survey results which showed that good CG was a crucial element in firm valuation. In theory, major investors have a number of motives that lead them to prefer investing in well-governed firms (Khurshed et al., 2011). To begin with, CG mechanisms have the potential to help reducing the costs of the monitoring and agency conflicts. Institutional investors who hold large stakes in firms have the tendency to bear high monitoring costs. Bushee and Noe (2000) indicate that institutional investors lean towards selecting potential investee firms that are characterised with higher disclosure quality as a mean to decreasing monitoring costs. In addition, and according to Del Guercio (1996), the existence of fiduciary responsibilities may force some major investors to prefer investing in companies with better CG practices that would prevent the occurrence of managerial fraud or negligence. The second motive is that institutional investors may prefer specific CG mechanisms that are linked to some firms characteristics. To illustrate, favourable firm performance may sometimes be linked to better CG mechanisms as reported by Gompers et al. (2003) and Larcker et al. (2007) that found well-governed firms have higher firm value and better operative performance. Furthermore, major investors with large investments could struggle to instantly liquidate their shares particularly during a governance collapse, which would push them towards investing in well-governed firms.

Some studies have investigated the CG relationship with major shareholders; however, their examinations feature limitations. For instance, some studies focus on: (i) one or two dimensions of CG; (ii) specific categories of major shareholders (i.e., institutional and foreign investors), which may present a narrow view of the relationship; or (iii) employing limited research methods (i.e. survey-based and quantitative assessments). On the contrary, this research intends to include all categories of major investors within the Saudi capital market and employ both quantitative and qualitative assessment to fill in the missing gap in the literature.

For instance, Dahlquist et al. (2003), Giannetti and Simonov (2006), Ferreira and Matos (2008), and Leuz, Lins and Warnock (2008) dedicated their efforts to examine the influence that CG practices have on the investment decisions process of institutional investors in regard of shares selection. Dahlquist et al. (2003), confirmed that no relationship is found between the ratio of control to cash flow rights and the foreign investors' shareholdings. In addition, Giannetti and Simonov (2006) found that having high control to cash flow rights ratios of principal shareholders could repel prospective foreign and local institutional investors, because it represents a large extraction of private benefits, and shareholders usually are in fear of expropriation especially in poorly controlled firms. Also, they found a clear relationship between CG quality and the shareholders base and showed that companies could use CG as an attraction tool to expand its shareholders base in the same way they use dividends to attract certain categories of shareholders. Ferreira and Matos (2008) show that companies with closely held ownership structure are unattractive to institutional investors. On a different angle, Leuz et al. (2008) reports that foreign firms with major internal shareholdings would also drive away institutional investors in the US because such firms can be problematic in terms of information transmission and monitoring costs.

Furthermore, Bushee, Carter and Gerakos (2010) investigated institutional investors preferences in CG mechanisms (under the board of directors' characteristics and shareholder rights), and the degree of CG influence over institutions' investment decisions. The findings showed that only 10% of their sample were affected by CG mechanisms. In contrast, McCahery, Sautner and Starks (2010) based their study on a survey to examine the perception of institutional investors toward the laws set by the country to protect investors, and the CG regulations that firms implement to protect investors too. The results showed CG is actually an important element of the decision-making process of their investments. Also, some of those institutional investors expressed the intention to involve in shareholder activism. The results have also shown that different categories of institutional investors are attracted to different CG mechanisms.

This raises the question of why CG preferences are varying among the categories of investors. One key answer can be the fiduciary duty. Individual investors are unlike institutional investors (e.g., funds, insurance firms, and financial institutions) in respect of their fiduciary duty. Institutional investors have demanding fiduciary responsibilities. Del Guercio (1996) reports that many of them lean toward firms that represent the concept of a prudent investment. As an illustration, Grinstein and Michaely (2005) found that companies with no dividends

distribution are excluded from the shares selection list of institutions investments, because they do not represent a prudent investment, which is ought to provide investors with steady dividends pay over the years. Thus, this fiduciary duty encourages institutional investors to select and invest in well-governed firms rather than poorly-governed firms as reported by Hawley and Williams (2000).

Moreover, since this research focuses on the second approach of examining the impact of CG on major shareholdings, the aims have been inspired by the work of Hawas and Tse (2016), Chung and Zhang (2011) and Bushee et al. (2013). These studies, however, are performed on firms operating in developed markets that have different market settings and levels of shareholders protection, comparing to the Saudi ones. In Hawas and Tse (2016), a CG index was constructed according to the combined code to test how CG influences different types of major shareholders before and during the recent financial crisis in the UK. For the whole period under examination, the findings revealed that CG is positively correlated to major shareholdings. On the other hand, major shareholdings had not changed even after making changes to the CG regulations. Among CG aspects that were examined, board composition and independence are the only ones that showed an effect on major shareholdings. The study concluded that major shareholders believe that CG was important throughout the financial crises. However, this study concentrated on examining the heterogeneity of the investment preferences of various categories of major shareholders in the UK, where shareholders protection is high, while our research focuses on the issue in the Saudi context, where investors' protections are deemed low. The combined results can then be explicitly generalised in this matter.

Likewise, Chung and Zhang (2011) and Bushee et al. (2013) investigated the influence of good corporate governance on the level of institutional ownership in US companies. They structured a CG index as a measure of good corporate governance. Chung and Zhang (2011) crafted two main indices to measure the level of CG in the selected firms. The first index includes anti-takeover provisions in a firm's charter and the second index includes the first index in addition to 12 CG mechanisms concerning board characteristics, audit committee characteristics, managerial ownership and compensation. An evidence was found showing that the level of institutional ownership is largely affected by the two main indices. Also, the study indicated that the legal types of institutional investors and the information asymmetry of the investee firms are responsible for determining the level of influence that CG indices may have on institutional ownership. Nevertheless, Bushee et al. (2013) findings showed that the level of on

institutional ownership is not significantly influenced by the anti-takeover index and has a weak positive relationship with the second index. On the other hand, it was shown that the level of institutional investors is weakly but positively correlated to the board characteristics index, however, this relationship is not influenced by the different types of institutional investors.

Furthermore, unlike this research, most of literature of the impact of CG on major shareholdings have adopted only one single research methods: either qualitative or quantitative. For instance, many studies have examined how investment decisions of institutional investors are affected by an investee firm's CG practices through 'surveys' (e.g., World Bank, 2005; PricewaterhouseCoopers, 2000; McKinsey and Company, 2002; McCahery, Sautner and Starks, 2016), while other studies performed their investigations by using secondary data only (e.g., Chung and Zhang, 2011; Khurshed, Lin and Wang, 2011; Bushee et al., 2013; Li, Ortiz-Molina and Zhao, 2008; Dahlquist et al., 2003; Giannetti and Simonov, 2006; Leuz et al., 2008; Ferreira and Matos, 2008; Aggarwal, Klapper and Wyszocki, 2005). The following sub-section discusses these limitations.

Survey-based studies:

World Bank (2005) and PricewaterhouseCoopers (2000) investigated the influence of firms CG practices on investment decision-making process of institutional investors in Asia and reported that most of institutional investors are not interested in the existence of independent directors and audit committee in an investee firm. In addition, McKinsey and Company (2002) surveyed a number of institutional investors around the world of whether they are influenced by CG characteristics of investee firms while making investment decisions. They found that institutional investors generally consider CG as important as financial data of an investee firm. In fact, a high percentage expressed their tendency to pay a premium for well-governed firms. A similar survey has been conducted by McCahery et al. (2016) has shown that institutional investors pay more attention to CG mechanisms in investee firms in the presence of weaker investor protection on the country-level. Nevertheless, these survey results might be convincing, but it is worth noting that there is an absence of pursuing any theoretical justifications from institutional investors regarding their relationship to CG mechanisms.

Studies with limited assessment and CG elements:

A number of studies considered only secondary data and/or limited number of mechanisms as proxies to CG to assess the impact of CG on investor decisions. These studies include Chung and Zhang (2011), Khurshed, Lin and Wang (2011), Bushee et al. (2013), Li, Ortiz-Molina and

Zhao (2008), Leuz et al. (2008), Ferreira and Matos (2008), and Aggarwal, Klapper and Wysocki (2005). For instance, Khurshed, Lin and Wang (2011) focused only on one category of major shareholders, i.e. institutional investors, and two aspects of CG in investee firms namely: board composition and directors' shareholding. Even though Chung and Zhang (2011) and Bushee et al. (2013) used a large number of CG mechanisms to examine the relation between corporate governance and institutional ownership, both studies were limited to secondary data only, which is the same case in Leuz et al. (2008) too. In addition, Li, Ortiz-Molina and Zhao (2008) concentrated on the effect of only the voting rights on the investment decision of institutional investors. Although Ferreira and Matos (2008) examined the preferences of different categories of institutional investors, including foreigners, they focused more on the country-level governance and firms characteristics using secondary data as well. On the other hand, Hawas and Tse (2016) differs from these studies in that they have included different types of major investors, including institutional investors, to examine their individual interests and preferences of many CG mechanisms, but limited their examinations to secondary data.

Given the above discussion, this research attempts to fill the gap in the literature by the inclusion of different types of major shareholders and employing both quantitative and qualitative methods to examine the impact of CG on the investment decisions of major shareholders to portray an enhanced picture of the issue in a developing market as Saudi Arabia. The next section discusses the literature found in the context of the kingdom.

3.4 Literature in The Saudi Context

3.4.1 Overview

The literature of the impact of CG on major shareholders in the Saudi capital market is still unsatisfying, which is a key motive for this research. La Porta et al. (1999) examined the ownership structures in 27 economies apart from some Middle East and North Africa countries (MENA) including: Saudi Arabia, Kuwait and the United Arab Emirates (UAE) as a result of limited data. Al-Harkan (2005) stated that the number of studies that investigated ownership structure in Saudi corporation prior to 2005 was only two. In reality, the Saudi Company Act

of 1965 (CA 1965) had no requirements for the disclosure of ownership structure and major shareholders information in the financial statements for investors' usage (Alajlan, 2004).

In order to examine the relationship between CG and major shareholders investment decisions, this section of the chapter discusses the literature in the Saudi context in relation to: (i) studies investigated the role of board quality in the capital market, and most importantly (ii) the role of major shareholders and their preferences in CG practices as well as the impact of such practices on their investment decisions.

3.4.2 Corporate Governance and Major Shareholders

In the Saudi context, some studies have focused on few issues of 'institutional investors' namely: their association to firm performance (Alhassan et al., 2015; Al-Sahafi et al., 2015; Abdallah and Ismail, 2017), their role and impact on CG system (Bukhari, 2014; Alakkas, 2016; Al-Dubai, 2019), and their relationship with corporate disclosures (Al-Bassam et al., 2015; Al-Janadi et al., 2016; Habbash, 2015; Razak and Zarie, 2015). However, there is a lack in the literature that examines the impact of CG practices on the process of investments decisions of major shareholders. To the researcher knowledge, there is no study that examines the impact of CG on the choices of shares of overall major investors and the CG preferences of different categories of major investors in Saudi Arabia.

The literature found in the Saudi context focusing on the relationship between CG and major shareholders is rather rare. However, some studies provided relevant linkage to the objectives of this research in different aspects such as: behaviour and dominance of wealthy families, dominance of governmental ownership and impact on investors, impact of directors' ownership on investors, types of major shareholders, CG perception of overall investors, and ownership structure.

In relation to the presence of major shareholders, the CMA requires all listed companies to disclose the ownership percentages of their shareholders who own 5% or more of their share on a yearly basis. Alakkas (2016) reports that major shareholders in 2015 controlled more than half of the shares traded in the Saudi capital market and most listed companies have at least one major shareholder. According to Albassam (2014), the average percentage of block ownership is %62 which is consistent with findings of other developing markets reported by Barako et al. (2006), Ntim et al. (2012a) and Samaha et al. (2012). In addition, Al-Janadi et al.

(2016) examined the impact of Government Ownership (GO) on CG and corporate disclosure in Saudi Arabia. They stated that GO is widely common in Arabia Public Listed Companies (PLCs). These findings promote the importance of major shareholders and their investment size in the Saudi capital market which may suggest the question of whether CG regulations affect the access of their investments to the market.

Abdallah and Ismail (2017) investigated CG practices and ownership structure and their relationship to firm performance in the Gulf Cooperation Council (GCC) region. They reported different types of majority ownership in these markets as follows; corporate investors (Institutional investors), government, wealthy investors (private owner or wealthy family), and foreign investors. Similarly, Al-Mulhim (2014) examined the relationship between CG and firm performance in Saudi Arabia and reported similar categories of major shareholders. Additionally, the study has documented the categories of major shareholders observed in the Saudi capital market namely: governmental institutions, wealthy families, listed companies and foreign investors. Additionally, Albassam (2014) categorised major shareholders as: government, institutional, block and board shareholdings.

Regarding the behaviour and dominance of major shareholders, Bukhari (2014) focused on the impact of institutions on the development of CG in Saudi Arabia. The findings show that family and kinship institutions have a negative linkage to the development of CG in Saudi Arabia. This is due to the fact that this type of firms has a habit of serving their own interests with little attention paid to non-family members of shareholders. This behaviour allegedly leads to the lowest compliance with CG practices. These findings helped the research of this thesis gaining an image of the nature of the current relationship between CG and institutional shareholders in Saudi Arabia. In a similar vein, Albassam (2014) indicated that major shareholdings in Saudi Arabia tend to negatively affect the independence of boards. The study argues that major shareholders affect board decisions and the general assembly agenda that may lead to the expropriation of the interests of small shareholders, which is considered a negative impact on good governance practices. On the other hand, Al-habshan (2015) claims that block owners in Saudi Arabia favour better CG practices to ensure a proper level of transparency and disclosure that would benefit their investments.

Interestingly, the findings of Alshehri (2012) reveals that governmental institutions invest in the market in response to the government plans without aiming to gain high returns because their objective is to implement the government policies in regard to economic developments.

Thus, this can be an indication that CG structure of investee firms have no impact on the investment decisions of governmental institutions because they embrace their own agendas and plans. This is supported by Darko et al. (2016) and La Porta et al. (1999) who stated that governmental ownership may not seek gaining profits but instead to achieve political objectives and control. However, Al-Janadi et al. (2016) found that decision-making process of investors is negatively affected by high GO in firms, which can be an incentive to focus on governmental holdings in this research.

In the same vein, Alasiri (2020) examined the role of CG regulations in attracting investors in Saudi Arabia, especially foreign investors. The findings indicate that there is a direct relationship between the implementation of CG regulations and the reduction of creative accounting and thus attracts foreign investors. This study suggests that foreign investors are willing to invest their capital in the Saudi listed firms if they implement good CG practices that are accepted globally. However, the study focused on questionnaires only without supporting the findings with actual financial data. Similarly, Al-Mulhim (2014) examined the relationship between CG and firm performance in Saudi Arabia and focused on different categories of major shareholders and their philosophies toward making investments in companies with poor and good CG practices. The study claimed that CG is seen as an important element of the capital market. In relation to directors' ownership, Darweesh (2015) examined the relationship between CG mechanisms and firm performance and market value. The results showed that investors are not in favour of high ownership of board members which turned out to have a negative relationship to firm performance, and this is supported by the results discussed earlier in Giannetti and Simonov (2006), Leuz et al. (2008), and Ferreira and Matos (2008).

With an emphasis on another aspect of CG in Saudi Arabia, Alzahrani (2013) claims that the concept of CG is still weakly understood, and the CMA should make more efforts in terms of educating investors about CG practices. However, this study has not provided a detailed discussion about the issue of investors' understanding of CG, which will be accomplished in this thesis. Additionally, Alhassan et al. (2015) interestingly underlines that potential investors are expected to comprehend the importance of good CG practices in relation to the protection of their interests. They assume that major investors are sophisticated and have the expertise to make reasonable judgments. This creates one of this research assumptions that major shareholders presumably take CG into consideration during the decision-making process of their investments, since they are sophisticated enough to comprehend the importance of CG in potential investee firms.

3.5 Conclusion

This chapter has presented a review of previous research on the several issues in relation of CG and major shareholdings. First, it begun by providing a theoretical background of the agency problem that may arise between owners and managers of companies. Conflicts may occur when mangers seek their own interests at the expense of shareholders' interests. Additionally, information asymmetry may also cause the agency problems. The second part of the chapter explores the ownership structure in many markets. This part is ought to draw up a clear picture of the types of shareholdings in global markets and whether major shareholders have a role to play in such markets.

The relationship between CG and major shareholders is examined via reviewing prior studies that investigate their role and preferences toward CG practices in their investee firms. This review assists in filling the gaps in the literature with helped developed the research questions. The last part presented in this chapters examined the ownership structure and the lack of literature that investigate the effect of CG practices on the investment decisions of major shareholders in the Saudi capital market. Although there is a lack of literature examining this issue, a number of studies have been reviewed to provide this research with a starting point to investigate the impact of CG on major shareholdings in the kingdom.

Chapter 4. The Context of Saudi Arabia and its Emerging Capital Market

4.1 Introduction

In the previous chapter, the current literature that concerns the relationship between CG and major shareholders have been reviewed aiming to understand the status of the issue in different capital markets. This chapter focuses on the local settings in Saudi Arabia. As mentioned earlier, the main objective of this thesis is to explore the evolution of CG in Saudi Arabia and investigate whether the CG structure of potential investee firms have an impact on the investment decisions of major shareholders. Saudi Arabia is a developing country that has its distinct political, economic, legal, cultural and social systems. These distinct systems lead individual countries to construct a CG framework in their own suitable approach (Oman, Fries and Buitter, 2004). With respect to CG regulations, it is necessary to demonstrate the current characteristics of these systems in Saudi Arabia.

This chapter is formed in six broad sections: (i) overview of Saudi Arabia; (ii) politics, law, and the legal system; (iii) the cultural and social systems; (iv) the economic system; (v) the journey of the Saudi capital market; and (vi) CG in Saudi Arabia.

4.2 Overview of Saudi Arabia

Saudi Arabia is a kingdom located in the southwest area of Asia and occupies most of the land in the Arabian Peninsula. It was founded in 1932 by King Abdulaziz Al Saud (1880-1953), who was able to unify both Hijaz and Najd kingdoms and other regions into one kingdom that became known as the Kingdom of Saudi Arabia (Al-Angari, 2004; Al-Turaiqi, 2008). The size of the land is approximately 2.14 million square kilometres, which 80% of it is formed by desert. The kingdom shares borders with Kuwait, Iraq and Jordan in the north, and is surrounded by Yemen and Oman in the south while the west side is totally bounded by the Red Sea, and the east side is bounded by the Arabian Gulf, Bahrain, Qatar and UAE (See Figure 4.1). The weather in Saudi Arabia is mostly hot in the summertime and the heat can reach up to 50 degrees and is fairly cold in the winter with temperatures reaching down to 0 degrees in some areas. The currency is the Saudi Riyal (SAR), where SAR 1 is equivalent to a fixed rate

of US\$ 0.267 (Bloomberg, 2018). According to the General Authority for Statistics in the kingdom, the population of Saudi Arabia is around 31 million based on their most recent statistical yearbook of 2016 (General Authority for Statistics, 2017). This population lives in 13 administrative provinces, where each province is headed by a royal family member. Around 78% of the population are under 40 years old and 32% are under the age of 15 years (Almadi, 2016). The capital city is Riyadh, and its major cities include Makkah, Al-Madinah, Jeddah and Dammam (Ministry of Education, 2018).



Figure 4.1: Map of Saudi Arabia

Source: Google Maps

The official religion in Saudi Arabia is Islam and the country is considered, by the Islamic world, to be the birthplace of Islam (in the seventh century), as it hosts the two holy mosques in Islam, which are located in Makkah and Al-Madinah. Makkah has the most important mosque to the Islamic world (The direction of prayers for all Muslims), while Al-Madinah hosts the mosque and the grave of Prophet Mohammad (Peace be upon him). As stated in the kingdom Basic Law of Governance (1992, p.3), particularly in Article 23, ‘the state shall protect the Islamic creed, apply the Sharia, encourage good and discourage evil’. This statement and others confirm the impact of Islam on the various aspects of life in the kingdom even in the business field, with the assurance of proper ethical policies and human equality

(Moustafa, 1985). Being the birthplace of Islam owes to the fact that the first language in the kingdom is Arabic, however, English is widely used in the business fields.

4.3 The Cultural and Social System

Saudi culture is deemed to be fairly homogenous. According to Idris (2007), there are two factors that have affected the Saudi culture namely: Arabic origins and Islam teachings (Sharia Law). Saudi Arabia is a tribal society, which is formed by past events and Arabic traditions. Saudi Arabia has never been invaded by other nations; therefore, its culture and traditions have formed themselves throughout the years with the influence of its locations and political importance. Menoret (2005) defines Saudi Arabia as the core centre of the Islamic and Arab world and sometimes it is considered their 'big brother' due to its economic and political dominance.

Interestingly, Field (1985) reported that Saudi people usually attempt to strengthen their relationships with employees and officials of governmental institutions to attain better services in the future. This way of personalising relationships is quite common amongst Saudis, which can sometimes interfere with implementing regulations. Similarly, Idris (2007) suggested that tribal relationships to employees in governmental institutions and business relations between individuals may also obstruct law enforcement.

Another controversial aspect of the Saudi society has been analysed by Falgi (2009) and Al-Matari et al. (2012), which is the minor changes in social manners. They state that the kingdom has known for hosting millions of nationalities who are active within the society and Saudis have been supplied with new technologies and a better education system. However, social norms and behaviours have not shown major changes. The authors believe that the solid power over authorities by some members of the royal family and their closely attached families (especially from Najd) are the main reasons for the slow progress of the society developments.

4.4 The Economic System

In the past, Saudi Arabia used to be a relatively poor country as 80% of its land was formed by desert, which indicates lack of natural resources (Al-Sayari, 2003). After the discovery of oil

in 1937, the financial status of the kingdom begun improving gradually. Since then, the country has been steadily developing in different fields, particularly in the economy until the kingdom became quite influential on the pricing and production of oil internationally according to Niblock (2004).

Saudi Arabia depends largely on the production of oil and possesses about 17% of the world’s oil reserves. The oil and gas sector forms 70% of the kingdom’s export earnings and 50% of its GDP. In addition to oil, other natural resources are found within the kingdom such as natural gas, gold, copper, and iron ore (OPEC, 2021). According to the World Bank (2018), Saudi Arabia had a GDP of US\$ 683.83 billion in 2017, which is the highest GDP amongst all the GCC and other MENA countries too (see Figure 4.2). Its huge oil resources make the country dominant among the MENA countries and has the highest income (FTSE Global Markets, 2006).

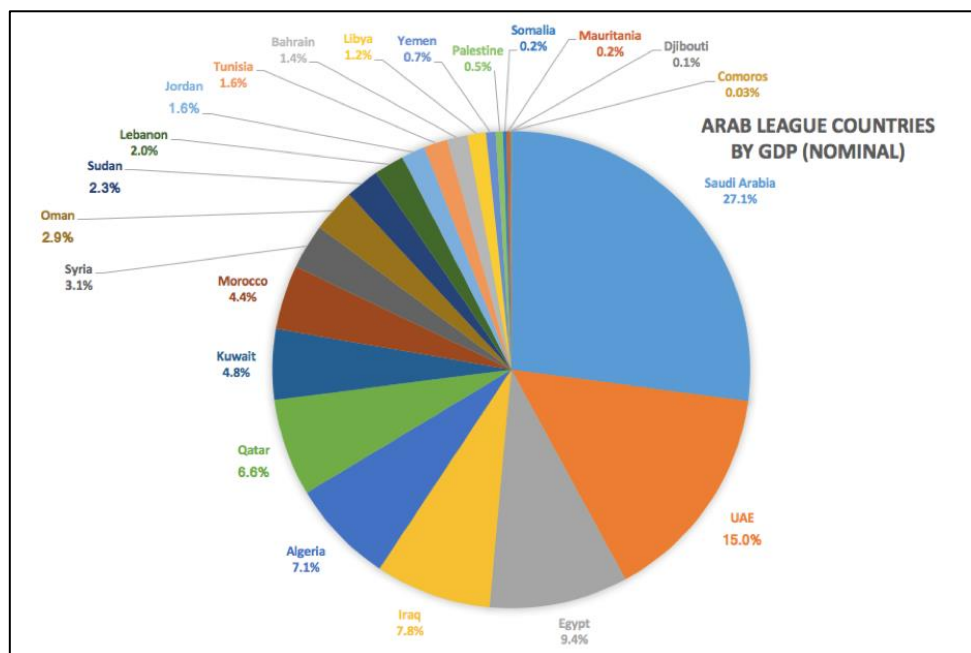


Figure 4.2: GDP of Arab countries in 2018

Source: World Bank (2018)

At the beginning of the third millennium, Saudi Arabia became determined to turn its economy to a more diverse one in order to limit its dependence on the income of oil production. The

government initiated major reforms in the economic and business field by eliminating heavy business restrictions, support privatisation, and focus on investors' protection (World Bank, 2013). In 2000, they started by establishing the Saudi Arabian General Investment Authority (SAGIA), which was responsible for all investment affairs in the country. Then, the government formed the CMA in 2003 to monitor all activities of the capital market (CMA, 2014), and it concentrated on refining the legal and economic structures which eventually enabled the country to join the World Trade Organisation (WTO) in 2005 (WTO, 2005). Ramady (2012) advances the idea that such reforms have contributed to the ease of business and to the rise of the private sector, and the foreign investors' involvement in the Saudi market. For example, in accordance with SAMA (2014), the private sector contributed to almost 50% of Saudi Arabia's GDP in 2013, while in 2003 the percentage was only 35%. Further, foreign investors eventually became able to participate in the capital market since 2015 (CMA, 2015). However, the economy in Saudi Arabia still experiences complications, which may cause disaffection of prospective investors. To illustrate, the government departments are somehow still characterised with bureaucracy, which can seriously drive investors away. As reported by World Bank (2016), the government efficiency in the kingdom is in the 90th place in their list, and the reason for such undesirable ranking is linked to the government dominant control over Saudi leading corporations (Al-Hussain, 2009).

Some scholars have analysed the consequences of the government total control of the politics in Saudi Arabia. For instance, Al-Rasheed (2010) noted that the dominance power that the government exercises on the country's politics has led the royal family in Saudi Arabia to be having a vital role in the local market. Additionally, Murawiec (2005) revealed that the Saudi Royal Family is involved deeply in the Saudi market as they have been granted multi-billion public projects through their private and semi-public companies, along with Najd descent businessmen, who are arguably considered to be second to the Royal family in the business market according to Niblock and Malik (2007). According to Almadi (2016), such businessmen are clearly among major shareholders in the Saudi stock market along with governmental owned/partly owned institutions and members of the Royal family.

4.5 Politics, Law and The Legal System

4.5.1 Politics and Law

Saudi Arabia is deemed to be an absolute monarchy and the throne is available to only male descendants of the founder King Abdulaziz Al Saud (Basic Law of Governance, 1992). The term ‘constitution’ is never used in the kingdom; however, scholars consider the Basic Law of Governance as the Saudi Arabian constitution. The Basic Law of Governance confirms Islam as the source of its law (Sharia), and it underlines that the king is the head of both the kingdom and the government, which forms a centralised political system in the kingdom. In accordance with the Basic Law of Governance (1992), the king’s responsibilities include ruling the local and international affairs of the kingdom as well as implementing proper arrangements and organising for the different divisions of government such as the appointing of the head of the three state authorities in the country: namely, the Executive Authority, the Legislative Authority and the Judicial Authority.

The Executive Authority is represented by the Council of Ministers, which works as an advisor for the king in relation to the governance of the kingdom. Council members are always appointed by the king himself every four years, and there is a possibility that they are reappointed for another four years based on the king decision. The Legislative Authority is also represented by a council, which is called the Consultative Council. This council’s responsibilities include issuing recommendations, developing new legislations, and improving old regulations with no power to pass or enforce laws (Majlis Ash-Shura, 2018). The third authority is the Judicial Authority which is responsible for applying the Sharia Law in the kingdom.

In addition, the king decisions are mostly the output of his meetings with senior members of the royal family and the religious icons (Shoult, 2006). However, all economic and finance-related matters are directed to the Bureau of Experts (BOE), which is a consultancy division under the government that was formed back in 1953 (BOE, 2015). Even though the Basic Law of Governance (1992) confirms that regulations in the kingdom are issued with affirmation of achieving fairness, consultation and equality, a number of researchers have put the quality of the legal system in the kingdom in question. According to Niblock (2004), the legislations and laws in relation to customers and investors’ protection and bankruptcy are regularly neglected or enforced on unregularly basis. Further, Hertog (2010) argues that due to the delays of court proceedings, the transparency of the Saudi Judicial system is limited as result of the meddling

of some members of the Royal family. On the contrary, Shoult (2006) and Ramady (2010) indicate that the establishment of CMA in 2003 had led to an evident enhancement in the application of business-related regulations in the Saudi capital market.

4.5.2 The Legal System

The process of developing the Saudi legal system has been rather slow in comparison to the kingdom's economic developments. Even though the Saudi market has improved significantly, the legal system has not kept pace with it, and remained a poorly-structured system (Hussainey and Al-Nodel, 2008; Al-Nodel and Hussainey, 2010; Al-Matari, Al-Swidi and Fadzil, 2012). Consequently, there have been a consistent urge for the need for a more developed legal system for the protection of the Saudi capital market and shareholders' interests.

4.5.2.1 Foundations of The Legal System

As mentioned earlier, the legal system in Saudi Arabia depends mostly on the Islamic teachings (Sharia), which is viewed as the main source of legislations in the country. The first article in chapter 1 in the Basic Law of Governance states that the principles of the Saudi Constitution are predominantly derived from the Holy Quran and Sunnah (Islamic sources of law) (Basic Law of Governance, 1992). However, the Islamic Sharia and the legal system in Saudi Arabia may pass legislations and laws that are originally produced abroad if they align with the Islamic Sharia. The CA 1965 in Saudi Arabia, for example, was mainly originated from the British Companies Act (Hussainey and Al-Nodel, 2008; Al-Matari et al., 2012). Also, as important, it is argued that the CA 1965 has French roots, as many of its articles (such as the ones concerning the types of companies) are based mostly on the French Law prior to 1966 (Koraytem, 2000). The author also confirms that some adaptations have been made in order to make such laws compatible with the Islamic teachings.

4.5.2.2 Laws and Regulations

The Saudi CA 1965 is the concrete base for legislations for companies. Nevertheless, this law suffered from weaknesses in various areas especially in regulations related to the capital market. These limitations were obstacles facing the pace of the economy developments in the kingdom; therefore, the Saudi government had commenced economic reforms in terms of enhancing legislations and regulations which resulted in the formation of Capital Market Law (CML), the Listing Rules, the Corporate Governance Regulations and many other regulations, with bearing in mind that these laws were also the outcomes of the collapse of 2006 in the capital market (Alkahtani, 2015). The new Company Act 2015 was based originally on the 1965 version; therefore, French roots still exist. However, the new Act was produced to meet the modern needs of firms and form an attractive business environment elevate investors participation in the kingdom market.

In addition to the CA 2015, the laws and regulations that are today linked to CG in Saudi Arabia are: the Saudi Accounting and Auditing Standards, the Principles of Corporate Governance for Banks Operating in Saudi Arabia, Listing Rules 2004, the Saudi Code of Corporate Governance, and the Capital Market Law 2003. Due to their direct association to the discussions in this thesis, the last two laws will be discussed later in the chapter.

Four shortcomings have been observed in such laws. First, these laws and regulations have neglected issues relating to ownership structure, especially in regard of major shareholder. On the contrary, in Italy which has a similar ownership structure to the Saudi's, regulators have issued a section in their law for internal control concerning these issues (Alakkas, 2016). Second, the Saudi laws have repetitively been criticised of being vague and confusing, which makes it hard for firms to comprehend and follow. For instance, in the Saudi code of CG, the definition that is stated for minority shareholders is "those shareholders who represent a class of shareholders that does not control the company and hence they are unable to influence the company", however, the code had no explanations of shareholders controls whether related to minority or major shareholders (Alakkas, 2016).

Third, some agencies have not enforced their laws properly, which places the power and impact of those agencies in question as well as the sanctions stated in the regulations of those agencies (Alakkas, 2016). Falgi (2009) confirms that, besides the inconsistency and ambiguousness of the Saudi CG laws, the sanctions procedures are seen as inadequate to prevent companies from

violating the laws. This limitation has motivated companies to pay little fines instead of fully implementing the CG regulations (Al-Kahtani 2015).

Fourth, as partially explained earlier, governmental agencies which regulate companies in relation to CG have different perception of CG, which leads to a conflict between laws imposed by those agencies. To illustrate more, the CMA and SAMA are the regulating bodies of listed banks, and both bodies introduced CG laws. Some provisions in the CMA CG regulations are not stated under the SAMA principles, which can be confusing to firms (Alakkas, 2016).

From the above discussion, the Saudi legal system is mainly based on Islamic teachings (Sharia) and have British and French roots to some extent. The CA 1965 and the newly established version of 2015 are the basis of legislations relating to firms operating within the kingdom. Other laws have been developed as a reaction of the capital market crash of 2006 and more attached to CG framework of the system such as Capital Market Law 2003 and the Saudi CG code. However, such laws have limitations that contribute to the ineffectiveness of the CG structure in the country.

4.5.3 Regulatory System of Corporate Governance in Saudi Arabia

4.5.3.1 Overview

In Saudi Arabia, there are two key regulators who manage the development and implementation of CG regulations namely: (i) the CMA and (ii) the Ministry of Commerce and Industry (MOCI). The CMA is responsible for listed companies only whereas the MOCI is responsible for listed and unlisted companies in the Saudi market. The main objective of the two regulators regarding companies is to ensure the compliance and implementation of provisions enforced by the CA and the Saudi code of CG (CGC) as well as aiming to protect the interests of shareholders and stakeholders and attract investments in a healthy business environment (see CA 2015, Articles 1 and 219). In addition, there are other institutions that affect the structure of Saudi listed companies such as: the SAMA, the General Authority of Zakat and Tax (GAZT) which is responsible for the implementation of Zakat and tax laws, and the Saudi Organisation for Certified Public Accountants (SOCPA) (see Table. 4.1). According to OECD (2012), such institutions and regulations have positively contributed to the quality of CG and non-CG regulations in Saudi Arabia (OECD, 2012).

| Law/ Institution | Year | Description |
|------------------------------------------------------------------------|---------------------------|---------------------------------------------------------------------|
| The Company Act (CA) | First: 1965 Last: 2015 | Regulations in regard of the legal framework of the Saudi companies |
| The Income Tax and Zakat Law | 1950 | The Taxation system in the kingdom |
| The Saudi Organization for Certified Public Accountants (SOCPA) | 1992 | The regulator of Accounting and Auditing policies in the kingdom |
| The Capital Market Authority (CMA)/The Capital Market Law (CML) | 2003 | The regulator and developer of the Saudi capital market |
| The Saudi Code of Corporate Governance (CGC) | First: 2006 Last: 2017 | Regulations in regard of CG practices in the Saudi capital market |

Table 4.1: Main Regulations of Saudi Companies

Source: constructed by the researcher

4.5.3.2 The Company Act (CA)

The first Company Act (CA 1965) in Saudi Arabia was released on 20 July 1965 (Basheikh, 2002). According to Alghamdi (2012), this version of the act was influenced by the British Companies Act. The main objective of its release was to govern the activities of companies operating in the kingdom (MOCI, 2019). The CA 1965 sought controlling the activities of commercial companies such as joint stock companies, partnership, liability and limited liability companies, corporations diverting and emerging, bond partnerships and foreign companies (Alshehri, 2012). There have been adjustments made to the CA 1965 in four separate occasions, particularly in 1967, 1982, 1985 and 1992 (Basheikh, 2002). The Act consisted of 15 chapters that provide 234 articles. This version of the act has demonstrated several articles in regard of CG practices such as the board of directors, disclosure and transparency and shareholders' rights and general assembly.

On December 2015, a new version of the CA has been released which suppressed the CA 1965. Companies in the Saudi market were given a period of one year only to ensure their total compliance with the regulations set out in the new law of companies. The new CA 2015 is ought to deal with many obstacles that faced the development of the Saudi market. It is constructed in a way that attracts companies and investors to a better business environment.

The new rules have also imposed better CG policies such as CEO duality, accumulative voting system, and new sanctions against violation of the law.

4.5.3.3 The Income Tax and Zakat Law

Zakat is an Islamic term which refers to the Islamic tax that is imposed annually at an annual flat rate of 2.5% of the aggregate monetary values of an individual assets, which was laid down by Royal Decree No. 17/2/28/8634 dated 1950 (Basheikh, 2002; Alkhtani, 2010). The law of Zakat has been amended in 1951 and 1956. The first Article of the law states that all Saudi individuals, shareholders of Saudi firms that are totally owned by Saudis, and Saudi shareholders of joint companies that are owned by Saudi and non-Saudi investors, have to pay Zakat with guidance of the Islamic teachings (Al Mulhim, 2014).

The Income Tax Law was first released in November 1950 and has also been revised few times in 1951, 1956, 1986, 2004 and 2018 (Basheikh, 2002; Department of Zakat and Income Tax, 2019). Individual employees, both national and expatriate, are not obligated by this law. However, there are six individuals who are obligated to this law in the kingdom including: (i) resident capital companies with respect to shares of non-Saudi partners, whether they are resident or non-resident natural or legal persons, (ii) Shares of non-Saudi partners in resident capital companies shall not include shares of non-Saudis held for speculation purposes through trading shares of joint stock companies in the Saudi capital market, (iii) Shares of non-Saudis in mixed companies, which are partners in resident capital companies, (iv) Individuals engaged in the natural gas and hydrocarbons investments.

In addition, the GCC countries had an agreement in June 2016 to enforce the Value Added Tax (VAT) across the region. In the following year, Saudi Arabia approved the outlines of the GCC VAT. In January 2018, Saudi Arabia has imposed the Value Added Tax (VAT) at a standard rate of 5%. The General Authority of Zakat and Tax (GAZT) defines VAT as:

An indirect tax imposed on all goods and services that are bought and sold by businesses, with a few exceptions VAT is imposed at each stage of the supply chain from the production and distribution to the final sale of the good or service.

GAZT is the government institution that has the duty of monitoring the application, management, and enforcement of VAT across the kingdom with the cooperation of other involved institutions (GAZT, 2019).

4.5.3.4 The Organisation for Certified Public Accountants

In 1992, the Saudi Organisation for Certified Public Accountants (SOCPA) was founded as a partially independent institution (Alsaeed, 2006). SOCPA is the entity that is responsible for the development and ratification of accounting practices and the Chartered Accountant system in the kingdom. The organisation main objective is to enhance the accounting profession in the kingdom by releasing approved accounting and auditing standards that are recognised globally. According to SOCPA (2012), the organisation has obtained recognition by the International Federation of Accountants (IFAC) in 2006 and was selected by IFAC to participate in the development of the accounting and audit profession (Albassam, 2014).

SOCPA was formed with a board of directors who reports directly to the Ministry of Commerce and Industry. The board is represented by the Minister of Commerce as the Chairman with 14 members (SOCPA, 2019). It is claimed that SOCPA has been an influential factor in the development of firms' audit quality and enhancing the confidence of investors in CG practices implemented by companies (Alsaeed, 2006).

4.6 The Journey of The Saudi Capital Market

In accordance with Alkahtani (2015), there are two main eras that the capital market has grown through in Saudi Arabia. The first era started nearly from 1932 until 2002. The second main era started in 2003 and on. The capital market has observed a chain of events throughout both eras, in particular, the financial crisis of 2006. The first recorded date of joint stock companies, commonly known as corporations or limited companies, in Saudi Arabia goes back to the year 1932. This is the date when the first joint stock company in Saudi Arabia was established and called the Arab Company for Cars. Years later and particularly in 1954, another joint stock company was established and called the Arabian Cement Company. This was followed by the authorisation of three electricity companies to begin business in the market. A year earlier in

1953, the known businessmen Al Mahfouz and Kaki established the first bank in the country, which was later called the National Commercial Bank (Ramady, 2010). Few years later, the government established another local bank called Riyad Bank to keep up with the speed of developments around the kingdom.

In the 1970s, the capital market witnessed the establishment of many joint stock companies. During the same period, the government had decided to unify the three electricity companies into one consolidated company. The incentive behind this decision was the additional charge-free shares which were issued to shareholders (Abdullah, 2006). In addition, the government decided to support the private industry financially by introducing six large governmental lending institutions, including: the Saudi Agricultural Bank, the Saudi Credit Bank, the Public Investment Fund and the Industrial Development Fund (Ramady, 2010).

Moreover, noticeable changes have been observed in the late 1970s in the Saudi capital market when the government decided to convert foreign banks, already working in the Saudi Arabia, into national banks. After this nationalisation plan took place, the government pushed the banks to sell their stocks to the public as public offers. Furthermore, privatisation programmes have contributed positively to forming a regulated market for the shares trading (Ramady, 2010). Consequently, investors around the country have become more interested and involved in stock trading during this decade.

Additionally, the first time the Saudi capital market had experienced the introduction of mutual fund was in the 1980s following the establishment of the National Arab Bank (Alanazi, 2012). These mutual funds played an important role in spreading the culture of investment among Saudi investors; however, the market was still comparatively small and lacks attractiveness. One of the market characteristics at the time was that many of the stock market operations, including selling and buying shares, were executed by unlicensed stockbrokers. At that time, the Saudi stock market had limited and insufficient regulations to control the activities in the market, therefore, those unlicensed stockbrokers continued trading in the market for years. The early 1980s has witnessed the rise of oil prices which in fact led to enhancements in the capital market, increases in shares traded on a daily basis, and increases in shares prices. As a result, the government noticed the urge for new legislations and reforms in relation to the capital market activities (Alkahtani, 2015).

One of the main reforms made by the Saudi government is the establishment of SAMA, which led to the suspension of the trading activities of the unlicensed agents. Following this, SAMA

was responsible for regulating the stock market activities and limiting them to the commercial banks only. Therefore, SAMA was solely granted the authority to supervise the shares trading to form a regulated market, and keep the financial operations stably running in the market (SAMA, 2018). Consequently, the IFC has recognised and begun monitoring the Saudi capital market as an emerging market that plays a vital role in the region and amongst other emerging markets listed in the IFC databases (Alkahtani, 2015).

In 1984, the government decided to introduce the Saudi Share Registration Company (SSRC) to be operated by the banks and monitored by SAMA, with a main responsibility of handling the data of shareholders in listed companies. Additionally, the SSRC was responsible to take on all of its operations such as the settlements, transfer, and registration of property through the automated system. In 1990, the Electronic Securities and Information System (ESIS) was first introduced as a further step of the development of the Saudi capital market, and to run an Automated Information System (AIS) for the traders in the market. The dealings in the Saudi capital market, when it was introduced, was limited to Saudi citizens until 1994, when citizens of the GCC countries became able to purchase and sell shares in the market. Later in 1999, the stock market began planning for foreign investors to be admitted in the market especially in banks mutual funds. The intention behind such plan was to encourage the flow of foreign capitals into the Saudi market (Ramady, 2010). The plan of allowing foreign investment in the Saudi market had also involved the setup of SAGIA in 2000 (discussed earlier).

In 2001, the ESIS was eliminated by the Saudi government and substituted with a new entity named Tadawul, which is the current name for the Saudi capital market. The CMA was responsible for the supervision over this establishment. As a result of the establishment of Tadawul, trade volumes increased noticeably, and the transactions and processes speed have improved rapidly by using the internet. Following the high increases in oil prices in 2005, the confidence in the Saudi market had risen too. From there on, Tadawul all Share Index boosted up from 2,500 points to approximately 16,700 points in 2006. Likewise, the market capitalisation had incredibly risen from US\$75 billion to almost US\$651 billion during that period. By 2009, Tadawul became comprising of 128 listed companies, and it emerged with the bond market, and bonds became available in Tadawul for trading (Saudi Arabia Report, 2009).

The Saudi market is nowadays well-known of some characteristics such as: concentrated liquidity and influential shareholders (institutions or government), and it is considered to be a

promising market that can be able to reach a developed market class in the future (Alsahlawi and Ammer, 2017).

4.7 Saudi Ownership Structure and Major Shareholders

This section presents the ownership structure in the Saudi capital market and how major shareholders gained power within the market over the years. Before the infamous crash of 2006, the Saudi capital market was branded as a market with a high level of ownership concentration. The majority of publicly-traded firms in the market were owned by the government and wealthy families (Aljahdali, 2014). Many individual investors had participated in purchasing shares in many privatised or newly formed firms; however, it seems that they have left the market quicker than anticipated. One explanation for such behaviour was the desire to purchase shares in the IPOs as they were offered at lower prices. Afterwards, they would sell such shares to benefit from their high initial returns. Consequently, these resold shares have been owned by limited number of major shareholders especially wealthy families (Aljahdali, 2014). Over the years, this situation has participated in creating high concentrated ownership in the Saudi capital market. Consequently, many of the strategic and discretionary decisions of companies' boards became under the control of few shareholders especially governmental agencies and wealthy families (Ramady, 2010).

The high level of ownership concentration in the Saudi capital market has started changing gradually after the country became a member of the WTO in 2005, which was caused mainly by the urge to liberalisation of the economy. The high and direct governmental ownership in the market has been reduced aiming at activating the role of the government agencies and funds in the market instead. As a result, the majority of government ownerships were resold to large governmental institutions such as Public Investment Fund (PIF), the General Organisation for Social Insurance (GOSI) and the Public Pension Agency (PPA). Such funds entered the Saudi capital market with huge budgets particularly in pre-governmental firms in addition to small, but influential, holdings in other private firms in the market (Aljahdali, 2014). Eljelly (2009) stated that although their small holdings in such private firms are usually not influential, but due to the new pattern of share ownership in Saudi Arabia, these funds had the ability to significantly control companies' matters even if their holding were as low as 1% only. This

explains the emergence of two widely common types of major shareholders in the Saudi capital market namely: wealthy families and governmental institutions.

The growing participation of different types of major shareholders is seen to have helped the development of the Saudi capital market. They are deemed to be notably useful in restoring balance by alleviating agency conflicts, re-allocating power among investors, strengthening CG and make the capital market more attractive to different investors (Aljahdali, 2014). Despite such changes in major shareholdings, the ownership of controlling families continued growing noticeably even after the establishment of the CMA back in 2003. For instance, some firms in the capital market are primarily owned by one family or one person such as the Kingdom Holding Company. Additionally, other firms such as Al Rajhi Bank, are mainly owned by Al Rajhi family with 45% of the bank shares with almost 60% of their board consisting of members of the family. Some wealthy individuals and rich families also hold large stakes through cross-ownership and pyramid structure, which is deemed to be a new trend of ownership in the Saudi capital market. This new pattern leads such investors to retain a full control with an average holding of 40% and above of entire shareholdings in 24 listed firms in the capital market (Aljahdali, 2014).

In general, previous studies have examined and reported the patterns of ownership in the Saudi capital market. According to Al-Tonsi (2003), the ownership of wealthy families was the prominent type with over 70% of ownership in the Saudi capital market in 2003, whereas the services sectors were dominated by the state. Alajlan (2004) reported that the majority of Saudi listed companies were owned by wealthy families which is in consistent with findings of Al-Harkan (2005). Piesse et al. (2012) and Al-Harkan (2005) has also indicated that the Saudi Arabian Monetary Agency (SAMA) found that the Saudi capital market is largely owned by families and the government.

In the literature of the last decade, the ownership structure in the Saudi capital market is categorised as a concentrated ownership as in civil laws countries. The Saudi CG model is referred to as an insider model where most companies are owned by governmental institutions and wealthy families as major shareholders (Solomon, 2010). Alamri (2014) found that wealthy families control more than 50 firms in the Saudi capital market, which explains the crucial role of the 'family and founder' issue that is broadly popular in Saudi Arabia (Robertson et al., 2013). Besides, as of June 2013, governmental institutions had controlled more than 12 listed companies in the capital market. However, prior studies (e.g., Al-Tonsi, 2003) claimed that the

majority of listed companies are owned by wealthy families whereas the rest are government-controlled. Nonetheless, the ownership structure has rather changed in recent years with several listed companies being owned mostly by foreign investors and small shareholders (Alamri, 2014).

The Saudi listed companies have been recently obligated to disclose their ownership structure that shows the percentage of at least 5% of a company's shares that is held by any shareholder. Alakkas (2016) reported that most Saudi listed companies feature a concentrated ownership pattern in 2015, where such companies are dominantly owned by an individual, an institution or a group of major shareholders. The study also indicated (see figure 4.3) that different categories of major shareholders hold 57% of the equity of listed companies whereas the 43% left are free for trade. It found that major shareholders appear in almost every single company in the Saudi capital market. As a result, it proves that until the year of 2015 more than half of the Saudi capital market is owned by major shareholders.

From the discussions above, it is noted that major shareholders exist dominantly within the Saudi capital market. Therefore, their role and investments sensibly seem influential, and more research is needed to examine their interests and what affect their investment behaviour especially in term of CG practices.

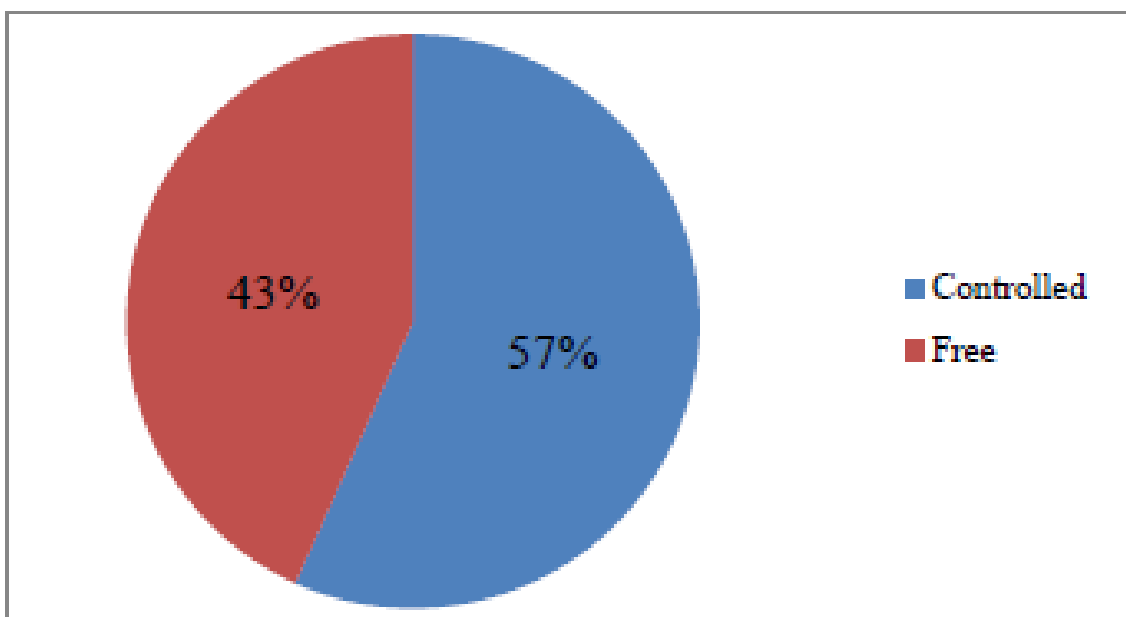


Figure 4.3: Controlled equity in the Saudi Capital Market

Source: Alakkas (2016, p. 63)

4.8 Corporate Governance in Saudi Arabia

4.8.1 Agency and Signalling Theories in Saudi Arabia

4.8.1.1 Agency Theory

The government of Saudi Arabia has made several reforms in the area of CG. It formed the code of CG regulation in 2006 which is regarded as a cornerstone of the reforms (Al-Abbas, 2009; Al-Nodel and Hussainey, 2010; Robertson et al., 2013). In comparing the Saudi CG code to other CG codes around the world, it also aims to eliminate agency problems that may arise between owners and managers by concentrating on transparency issues, accountability and duties of companies' boards of directors (ROSC, 2009; Alshehri and Solomon, 2012). In the Saudi context, this is deemed to be an important issue because of the existence of high ownership concentration in the Saudi capital market (Al-Abbas, 2009; Al-Nodel and Hussainey, 2010). The issue of ownership concentration may have an adverse effect on the rights of minority shareholders (Baydoun et al., 2013); resulting in conflicts of interests between major shareholders and those small shareholders. For instance, in the Saudi market, major shareholders can assign their friends and relatives as members of boards. Consequently, this may indicate that the interests of minority shareholders can be overlooked at the benefit of major shareholders. Additionally, individuals with good government ties can be appointed in boards without any judgement on their qualifications and capability in performing their duties (Haniffa and Hudaib, 2007; Boytsun et al., 2011). These actions can be influential in the issue of potential investment opportunities; therefore, the agency theoretical framework is seen to be most appropriate in the context of Saudi Arabia.

4.8.1.2 Signalling Theory

According to Al-Nodel and Hussainey (2010), the formation of the Capital Market Authority (CMA) in 2003 have contributed to the improving of the area of transparency and information disclosure and alleviating information asymmetry. To be specific, Listing Rules, which was issued in 2004, requires listed companies to disclose timely information to the capital market concerning any major changes related to either performance, contracts, ownership structure, and board composition and structure. As a result, distinguished improvements were witnessed

in the area of reporting of both financial and non-financial information in the annual reports of listed companies. In addition, Saudi regulators have seen the capital market as an external CG mechanism and have undertaken steps, through CG reforms, to reinforce it to help increasing the number of companies and improving the institutional investment. Since 2005, the Saudi capital market have experienced a substantial rise in the number of companies being listed. Due to the fact that these newly listed companies would have the need to gain financial support for their establishment, developments in CG issues related to major shareholders and their participation in the market as a result of easing information asymmetry would be attractive for future major investments by block-holders.

4.8.2 Emergence of Corporate Governance in Saudi Arabia

The evolution of CG laws in Saudi Arabia has been primarily derived by two crucial factors (Al kahtani, 2013). First, the urge to develop the economy and the capital market in Saudi Arabia, and then the need to increase the level of accountability of the members and executives in the boards of listed companies. In order to improve the Saudi economy image and maintain a reliable one as a country, regulators in Saudi Arabia have legislated many critical legal and economic policies especially after the year of 2000. Almneef (2006) reported that CG was a topic that he had never heard of in Saudi Arabia before 2000. Since the topic of CG is rather new in the country, the following events or steps are the recent ones that can shed further light on the modernisation process of the Saudi economy, particularly the capital market, which eventually resulted in the emergence of CG regulation.

To begin with, in 1999 the Supreme Economic Council was established according to instructions by the Saudi executive authority. The establishment of this council indicates that economic developments are becoming a key issue within the country. The Supreme Economic Council is headed by the King and consists of a number of ministers and deputy ministers and the chairman of the CMA board. Besides, the council has a number of responsibilities with being a supervisor of the country's economic regulations and policies, which is based on the principles of comprehensive social welfare and a free-market economy (Supreme Economic Council Law, 1999).

In addition, when SAGIA was formed in 2000, one of its key aims was forming a pro-business environment, where complete services are provided, and a greater number of investment

opportunities are discovered especially within the energy, transportation and knowledge-based sectors. Also, another significant aim of this authority was to remove any obstacles facing local and foreign investors in relation to starting up or running a business (SAGIA, 2014). Besides, one of its strategic goals was to lead the Saudi economy to reach a ranking between the top 10 countries in the World Bank's list, as stated by the SAGIA commissioner. As a result of continuous developments in the economy throughout the years, the Saudi economy was ranked 13th in the World Bank 2009 'Doing Business' report.

The approval of the CMA, which was introduced in 2003, was a substantial history point for the emergence of CG in Saudi Arabia. The CML included sixty-seven articles that regulate the capital market activities and provide the CMA with the power to control the market and its listed companies.

The second crucial reason for the evolution of CG in Saudi Arabia was the enormous collapse of the Saudi capital market in February 2006. The Saudi capital market suffered a rapid collapse of \$480 billion in equity losses, accounting for 53% of the entire capital market valuation (see Figure 4.4). This failure drove the Saudi authorities, especially the CMA, to protect the securities and investors interests in the market because it was notably sensed that investors begun losing confidence in the market, which demonstrated the need for a well-structured code of CG in Saudi Arabia (Ramady, 2010). Consequently, the CMA board started up the process of producing a code of CG for the first time in the market history. At the end of the same year, the CMA issued the final draft of the first Saudi code of CG, which took into consideration the principles of CG that are recognised internationally such as the OECD principles of CG and the UK code of CG as presented in Cadbury and Greenbury reports (Riyadh Chamber of Commerce and Industry, 2007). It is noteworthy to mention that this first code of CG presented the regulations as a set of voluntary, not compulsory, guidelines for the management of listed companies and encouraged compliance.



Figure 4.4: Saudi General Capital Market Index (2006)

Source: the CMA website

Although the laws regulating companies' activities, including their directors and employees, have already been enforced in Saudi Arabia through the CA 1965 (Al-Razeen and Karbhari, 2004; Hussainey and Al-Nodel, 2008), there was a general understanding that the CG in Saudi Arabia had not been formally recognised until the introduction of the first code of CG at the end of 2006 (Al-Moataz v Hussainey, 2013; Al-Nodel and Hussainey, 2010; CMA, 2006; Soliman, 2013a, 2013b). It is argued that CG issues within the capital market had begun occurring prior to its plunge in February 2006. Alshehri and Solomon (2012) and SFG (2009) indicate that the CMA and investors in the market neglect focusing on such issues because they were paying more attention to the abnormal gains during the period up to the crash date.

4.8.3 A Review of The Corporate Governance Code in Saudi Arabia

4.8.3.1 Overview

The first Saudi Code of CG regulations (CGC 2006) was released on 12 November 2006 (see Appendix F). The code was constructed and devoted to listed companies in the Saudi capital market to ensure their compliance to CG practices with higher standards to protect the interests of shareholders and stakeholders. The code was mainly influenced by the CG principles

published by the OECD in 2004 (Alshehri, 2012) as well as the Cadbury and Greenbury reports (Riyadh Chamber of Commerce and Industry, 2007). The CMA is the accountable authority for regulating the Saudi capital market and a major player in the process of CG developments (Alshehri and Solomon 2012). As discussed earlier, the CGC 2006 has been modified in four occasions by the CMA and the nature of such modifications is only mandating certain voluntarily provisions. Therefore, the following sub-sections explores the CGC 2006 and the recent version of 2017 as well as the modifications made to the CGC 2006 by the CMA.

4.8.3.2 The First Code of Corporate Governance 2006

This code is voluntary in nature and follows the UK ‘comply or explain’ approach, which requires listed companies to disclose information about followed and unfollowed provisions with an explanation for non-compliance (Falgi, 2009; Aguilera and Cuervo-Cazurra, 2009; Al-Abbas, 2009; Alshehri, 2012; Seidl et al., 2013). It seems that the CMA implemented this approach to enforce mandatory provisions in the following years (Aleshaikh, 2018). This explains the nature of modifications made to the CGC 2006 (explained later in the chapter). The code consists of 19 Articles which are presented within five main sections namely: (i) Preliminary Provisions; (ii) Rights of Shareholders and the General Assembly; (iii) Disclosure and Transparency; (iv) Board of Directors; and (v) Closing Provisions.

The first section of the code describes the preliminary provisions with definitions and the linkage to other relevant pre-enforced regulations such as rules released in the Saudi CA 1965. In the first Article, the primary objective of the establishment of the code is to enhance the compliance rate of best CG practices in the Saudi capital market. In Article 1b and 1c, the code states that the principles included are directed to all listed companies in the Saudi capital market and they must disclose the provisions implemented and the provisions that are not implemented with their justifications. In Article 2, the code presents the key definitions of several expressions and terms including: Independent Member, Non-Executive Director, First-Degree Relatives, Stakeholders, and Accumulative Voting, to help listed companies to properly comprehend their meanings and implementations.

The second section of the code illustrates the provisions related to the rights of shareholders and the general assembly. It requires listed companies to protect shareholders’ rights such as their shares of the distributable profits and the company’s assets upon liquidation. Additionally,

it confirms in Article 4 the necessity of specifying the procedures and precautions that enables shareholders to exercise their lawful rights and access to information. This section also indicates in Article 5 that the general assembly is supposed to be held in six months following the end of the company's financial year with specifying the date, place and agendas at least 20 days prior the date of the general assembly meeting. Article 5b requires companies to invite a general assembly based on a request of its external auditor or a number of its major shareholders who own at least 5% of the company's equity. Moreover, the company must announce the details related to the general assembly on their own website as well as the capital market website (Tadawul). Article 5f asserts that shareholders have the right to participate in the general assembly meeting, hence, the board of directors is supposed to bring their issues into the discussions during the meeting especially major shareholders who have the right to request the addition of one or more topics to the agenda during the preparation phase of the meeting.

Regarding the issue of information asymmetry, this section requires board of directors in Article 4b to grant shareholders with open channels to information to allow them to exercise their rights. This information must be adequate and accurate and shall be provided and updated on a regular basis within certain times, and the company is supposed to employ the most efficient methods of communication with shareholders to enable them to make informed decisions. In addition, the company is obligated to report to the capital market website (Tadawul) with the outcomes of the general assembly meeting immediately. Companies that fail to deliver such information shall be penalised.

Furthermore, this section covers the voting rights of shareholders. Article 6b focuses on enhancing the participation of shareholders especially small shareholders by recommending the implementation of the accumulative voting system, which is a one-share-one-vote policy. This policy has been optional until its mandate in January 2012. The US and the UK have been implementing this policy along with other developed countries which mainly aims to increase the impact of small shareholders on the appointment process of board of directors (Adams and Ferreira, 2008).

The third section of the Saudi code of CG presents the disclosure and transparency policies. Article 8 asserts that companies are required to lay down in writing all policies and rules in relation to disclosure. Additionally, Article 9 indicates that in addition to the mandatory Listing Rules, companies are required to report the composition of their boards comprehensively in their annual financial statements by including types of board members and the independence

level of boards. Companies are also supposed to report information about the formation of the board sub-committees such as the Audit Committee and the Nomination and Remuneration Committee, by describing their jurisdictions and duties and providing their names, names of their chairmen, names of their members, and the total number of their meetings.

Moreover, the code illustrates policies related to boards compensation. Article 9e states that companies are required to disclose details of compensation and remuneration paid to the chairman, board members, and top five executives who are paid the highest in addition to the CEO and CFO if they are not categorised within the top five. The code does not recommend or enforce limits on compensations paid to board members, however, Article 17 indicates that such compensations can be either a lump sum amount, attendance allowance, or a specific percentage of the profits.

According to Berle and Means (1932) and Davidson et al. (1996), the board of directors' role is mainly to seek the protection of its shareholders interests. Therefore, the fourth section of the code concentrates on CG policies that are designed to improve the role and functions of the board of directors. Articles 10 to 18 provide numerous of provisions which relate to main functions of the board of directors, responsibilities of the board, formation of the board, board committees, board meetings, remuneration of board members, and conflicts of interest within the board.

To begin with, the elimination of agency problems and the maximisation of shareholders wealth in the company are presented in the code as the core roles of the board of directors. The main functions outlined in Article 10 include: approving monitoring strategic plans and objectives for the business, laying down and monitoring regulations for internal control system, drafting an internal code of CG regulations which should not contradict the Saudi code of CG, and laying down policies and procedures for the board membership.

In addition, Article 12 presents the policies related to the formation of the board of directors. The code points out that boards must have between three and eleven members including executive and non-executive directors, but the majority has to be non-executive with the requirement that at least two or a third of board members are independent. Besides, board members are supposed to be elected during the general assembly by a maximum of a three-year contract.

In order to improve the monitoring role of the board, Article 13 requires companies to separate the role of CEO and chairman. This Article states that the chairman should be a non-executive

member. Additionally, Article 12h points out that board members are not allowed to act as a board member in more than five boards in the Saudi capital market to enable them concentrating on their duties and responsibilities in their respective companies.

Regarding the board sub-committees, Al-Moataz (2003) reveals that the only board sub-committee that was formed by listed firms is the Audit Committee. According to Al-Twaijry et al. (2002), Al-Moataz (2003), and Al-Lehaidan (2006), following the resolution of 1994 that was released by the Ministry of Commerce, companies were required to establish Audit Committees. Prior to the year of 1994, all companies had not formed board committees (Piesse et al., 2012). In 2001, Al-Qarni (2004) found that the number of companies that established Audit Committees were only five.

Articles 14 and 15 in the Saudi code of CG require listed companies to establish the Audit Committee and the Nomination and Remuneration committee. The code outlines the types, formation and policies required in relation to the board sub-committees. In accordance with Article 14, the Audit committee shall consist of at least three board members. Since the presence of non-executive directors is crucial to the CG regulations, executive directors' membership is not allowed in this committee. The Audi committee is obligated to report the board of directors with transparent information of their performance, findings, and decisions. The code requires boards to appoint at least one member of a financial and accounting speciality within this committee.

In this version of the code, the establishment of the Nomination and Remuneration Committee was a recommendation. However, it became a mandatory provision in 2010 and effective from 2011 (see Appendix F). Article 15 outlines the duties of this committee which include: confirming the independence of board members every year, laying down adequate and clear policies related to the remuneration of top executives and board members, identifying the negative and positive aspects of board practices and providing feedback.

The final part of the code to be reviewed is board meetings. Article 16 requires the board of directors to carry out their duties and shall endeavour to attend board meetings. The board of directors is required to meet on a regular basis. Additionally, the chairman is supposed to consult other board members in relation to issues to be discussed in meetings. All necessary documents must be delivered to board members in a reasonable time prior to the meeting to enable them to prepare for the meeting. Finally, meeting minutes should be documented for the deliberations and the voting and ensure a full access to them.

4.8.3.3 Modifications of The Code

Since its release in 2006, the code has been revised repeatedly to mandate certain provisions (Alshehri, 2012). Since the CGC 2006 is voluntary in nature, the nature of such revisions was only to turn some provision into mandatory. For instance, Article 9, which demonstrates disclosure requirements of board of directors, has been mandated for all listed companies by the CMA decision 1-36-2008 on 10 November 2008, and effective immediately. Listed companies became obligated to report other information related to the new distinction rule of executive and non-executive board members, the multiple board membership of directors, remuneration of board members, and disclosure of penalties charged upon the firm by the CMA. Additionally, the same decision mandated Article 12 which regulates the membership of most board directors (CMA decision 1-36-2008), effective from 1 January 2009. The mechanisms related to the appointment and responsibilities of the Audit Committee in Article 14 has been made mandatory (CMA decision 1-36-2008), effective from 1 January 2009.

In the following period, the CMA has announced a timetable of the mandate of some articles. For example, Article 15, which related to the Nomination and Remuneration committee, was scheduled to be mandatory starting from 1 January 2011 (CMA decision 1-10-2010 - dated 16 March 2010). Some elements of Articles 5, 10 and 12, which discuss issues in relevance to rights of shareholders in the general assembly, the main functions of the board, and the formation of the board, were programmed to be mandatory in 2013 (CMA decision 3-40-2012 - dated 30 December 2010). Table 4.2 presents the articles details of the mandated provisions from 2008 to 2012.

| Article | Paragraph | Decision and Date | Article Details | Effective From |
|---------|-----------|------------------------------------------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|----------------|
| 9 | All | Decision # 1-36-2008 Date: 10/11/2008 | Disclosure in the Board of Directors' Report – Paragraphs A to G | 10/11/2008 |
| 12 | C & E | | Formation of the Board: (c) The majority of the members of the Board of Directors shall be non-executive members. (e) The independent members of the Board of Directors shall not be less than two members, or one-third of the members, whichever is greater. | 01/01/2009 |

| Article | Paragraph | Decision and Date | Article Details | Effective From |
|---------|-----------|------------------------------------------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|----------------|
| 14 | All | | Audit Committee – Paragraphs A to C | 01/01/2009 |
| 15 | All | Decision # 1-10-2010 Date: 16/03/2010 | Nomination and Remuneration Committee – Paragraphs A to C | 01/01/2011 |
| 10 | B | Decision # 1-33-2011 Date: 30/10/2011 | Main Functions of the Board of Directors: (b) Lay down rules for internal control systems and supervising them. | 01/01/2012 |
| 5 | I & J | Decision # 3-40-2012 Date: 30/12/2012 | Shareholders Rights Related to the General Assembly: (i) Shareholders shall be enabled to peruse the minutes of the General Assembly; the company shall provide the Authority with a copy of those minutes within 10 days of the convening date of any such meeting. (j) The Exchange shall be immediately informed of the results of the General Assembly. | 01/01/2013 |
| 10 | C & D | | Main Functions of the Board of Directors: (c) Drafting a Corporate Governance Code for the company that does not contradict the provisions of this regulation, supervising and monitoring in general the effectiveness of the code and amending it whenever necessary. (d) Laying down specific and explicit policies, standards, and procedures, for the membership of the Board of Directors and implementing them after they have been approved by the General Assembly. | 30/06/2013 |
| 12 | G | | Formation of the Board: (g) On termination of membership of a board member in any of the ways of termination, the company shall promptly notify the Authority and the Exchange and shall specify the reasons for such termination. | 01/01/2013 |

Table 4.2: Details of mandated Articles of the CGC 2006

Source: constructed by the researcher

4.8.3.4 The Recent Code of Corporate Governance 2017

As discussed earlier, the CGC 2006 was constructed as a guidance of CG practices for listed companies in the Saudi capital market. This code mainly followed the ‘Comply or Explain’ approach. In contrast, the newly established Code of CG 2017 (CGC 2017) was released as a mandatory code. The CGC 2017 consists of 12 main sections and 98 articles with a new model of the compensation of board members comparing to only 5 main sections and 19 articles in the CGC2006 (see Appendix G). This code is going to be explored as part of this research objectives which is concerned with the evolution of CG in Saudi Arabia. However, the new mechanisms included in the CGC 2017 are not employed in the quantitative and qualitative analysis of this research as the selected testing period is from 2013 to 2017

The CMA swapped the old version of the code of 2006 with a newly enhanced version in April 2017, effective from January 2018. The new regulations have developed several aspects of CG policies in place such as the rights of shareholders, the duties and rights of the board of directors, the disclosure and transparency practices of listed firms, and an improved clarity of the board functions and responsibilities.

One of the main motivations of issuing the new Saudi code of CG was the desire of the Ministry of Commerce and Industry and the CMA to revive and emphasize the importance of implementing CG practices in listed firms in a practical manner (Al Ahmary, 2018). The positive effects of applying such practices are not recognised only within firms, but they can be directly observed within the business environment as a result of the impact of companies’ sustainability and growth over the whole economy (Alotaibi, 2015).

Since the release of the CA 2015, the CMA was also motivated to revise its code of CG so that both laws can be harmonised. In addition, the Saudi economy started lately to open its capital market to foreign investors, and to attract such investors the regulatory framework especially CG regulations had to be reformed and elevated to an acceptable global standard (Huber, 2015, cited in Al Ahmary, 2018).

Based on the policies released in the CA 2015, the CMA undertook a detailed reassessment of its code of CG in order to be imposed upon listed companies. The CMA reviewed international standards published by recognised bodies namely: the OECD, the International Governance Network, Basel Committee on Banking Supervision, the International Financial Institute, and the UK Corporate Governance Code along with CG regulations implemented in the Gulf

Cooperation Council countries (Huber, 2015). Besides, the CMA has also reviewed the CG regulations that were designated to banks sector in the Saudi capital market, which was released by the Saudi Arabian Monetary Authority. The banks CG laws have also been ratified within the CA 2015, which focused on the equal and fair dealings with shareholders without favouritism and granting them open channels of information which assists them in fulfilling their needs and fully exercising their lawful rights as well as the rights of different stakeholders of banks (CA 2015, Articles 87, 80 and 90).

The new Saudi code of CG 2017 targets several issues. First, it targets enhancing shareholders activism by encouraging them to play their role and exercise their lawful rights equally. Second, it comprehensively explains the roles and duties of the board of directors, board sub-committees, and the procedures followed for decision making. Third, it pays more attention to the issue of transparency and competitiveness in the capital market. Fourth, the code provides new policies that deals in detail with issue of conflict of interests. Fifth, it emphasises on the importance of accountability and internal control system related to firms' workers. Sixth, it provides new policies in regard of stakeholders' rights. Seventh, it presents new polices that concerns the performance evaluation of boards.

In addition, the new code underlines new definitions of key terms in the CG regulations that were not fully understood by listed companies. For instance, companies encountered difficulties in differentiating between the types of board members namely: independent, executive, and non-executives. In some cases, companies used to categorise a board member as independent and non-executive combined. Therefore, the new code now defines an independent member as "a non-executive member of the Board who enjoys complete independence in his/her position and decisions and none of the independence affecting issues stipulated in Article 20 of these Regulations apply to him/her" (see Appendix G, Article 1). Besides, the new code provides also a new definition of a non-executive member as "a member of the Board who is not a full-time member of the management team of the Company and does not participate in its daily activities" (see Appendix G, Article 1).

Furthermore, by taking into consideration the cultural and social norms in the Saudi environment, the new Saudi code of CG highlights a revised definition of relatives. The previous CG laws linked this term to only the first-degree relatives. However, the new CG regulations extends the definition to the fourth degree. The new definition is deemed as an attempt to deal with a pervasive norm in Saudi Arabia that the family is the only loyal party in

the business environment unlike in some developed countries such as the US and UK (Hickson and Pugh, 1995).

The rights of shareholders have been developed in the new code since they are the most influenced by any misconducts of the actions of firms' boards. The code motivates shareholders to be active and engage in general assemblies and encourage them to use their voting rights to have an impact on their firms, so boards can be aware that they are being monitored and accountable for all of their actions. In support to this issue, under the CA 2015, shareholders now can bring sole or grouped liability claims against the members of board of directors (CA 2015, Article 80). Besides, the new code has confirmed the right of accumulative voting system that prohibits the use of the vote of a single share more than once, which grants small shareholders the opportunity to have an impact on boards (Article 8b).

Article 5 of the CGC 2017 requires listed companies to lay down in writing the exact policies followed to ensure that all shareholders have a full access to all relevant information of the company such as books and information about their operations, strategies and investments. This article also requires boards to enable shareholders to monitor their actions and ensure they can exercise their right in holding board accountable for negligence or manipulation. However, the code prohibits shareholders from interfering in boards operations except when they are board members or present in the general assembly (Article 7).

Regarding the board of directors, the new code provides 25 articles that fully explain issues related to boards such as their composition, selection, membership, and termination. These articles provide a more comprehensive explanation of their roles and responsibilities and focus on issues relation to their independence, meetings, compliance with laws, and monitoring duties (Articles 16-40). For instance, Article 27 requires chairmen to encourage their board members to engage in useful discussions and grant them the opportunity to evaluate the executive management aiming at improving their performance. Additionally, CEO duality issue has been underlined in this code as Article 24 states the combination of the position of chairman and an executive role is not permitted at all circumstances even if the company's statute stipulated otherwise. Besides, no one in the company is permitted to gain absolute power to enforce decisions in the company. This emphasis is justified by the findings in the CMA annual report in 2015 (as cited in Al Ahmary, 2018), which found that the laws of CEO duality had been widely breached.

In addition, the CGC 2017 presents new and developed regulations in regard of characteristics of board members which may counteract their independence. For example, Article 20 states that the independence of a board member is negated if: he/she owns at least 5% of the company's equity or of its affiliates, he/she is a representative of a company that owns at least 5% of the company's equity or its affiliates, he/she is a relative of any of the company's board member or top executive directors or its affiliates, he/she has been an executive or an employee of the company in the last two years, or he/she is involved in activities that compete with company.

Moreover, the attention given to board sub-committee has grown in the CGC 2017. Now it requires board to establish a new committee named the Risk Management Committee. The board is required by the CGC 2017 to work thoroughly with this committee to fully comprehend and evaluate the risks facing the firm. Article 72 indicates that such committee must consist of at least three members, and the chairman and the majority of its members have to be non-executives with reasonable backgrounds in finance and risk management. This committee is responsible for laying down rules that govern the risk assessment of the firm which takes into consideration its nature of operations, supervising their implementation, and providing periodic evaluation reports. Besides, Article 71 indicates that the committee must have the ability to identify the acceptance level of risk for the firm and support the management with an insightful assessment of risks that face the firm throughout the financial year.

According to Article 95, boards have also the option to establish other types of committees that serve the needs of the firm. An example of such committees can be what is lately known as the Corporate Governance Committee. The main objective of this committee is to supervise the CG practices of the firm and to ensure compliance with CG regulations by delivering annual reports to the board. Table 4.3 presents a comparison between the CGC 2006 and CGC 2017.

| Code Aspect | CGC 2006 | CGC 2017 |
|--------------------|------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------|
| Issuance Date | November 2006 | April 2017 |
| Number of sections | 5 | 12 |
| Number of Articles | 19 | 98 |
| Mandate level | Comply or Explain – some provisions became mandatory over the years. | Fully mandatory |
| Regulator | The CMA | The CMA |
| Motivations | <ul style="list-style-type: none"> • Collapse of the capital market | <ul style="list-style-type: none"> • Enhancing the regulatory oversight of listed firms |

| Code Aspect | CGC 2006 | CGC 2017 |
|---------------------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| | <ul style="list-style-type: none"> Restoring investors' confidence Protection of shareholders and stakeholders' interests | <ul style="list-style-type: none"> Harmonising the CG regulations with the CA 2015 |
| Base of Regulations | The Cadbury Report & the OECD principles | International standards published by the: <ul style="list-style-type: none"> OECD International Governance Network Basel Committee on Banking Supervision International Financial Institute UK Corporate Governance Code |
| Main Features | <ul style="list-style-type: none"> Assisting BOD to reduce agency cost Introducing new key terms and regulations Mainly influenced by the Anglo-American CG model Not compatible with concentrated ownership structure. Overlapping with other laws No distinction between major and minor shareholders No regulations for internal control process No emphasis on the external auditor role | <ul style="list-style-type: none"> More emphasis on shareholders rights More emphasis on duties and rights of BOD More elaboration on disclosure & transparency practices Enhanced demonstration of BOD functions and responsibilities Underlining new definitions of the key terms Encouraging shareholders activism Establishing new board sub-committees |

Table 4.3: Comparison between the CGC 2006 and CGC 2017

Source: constructed by the researcher

4.9 Corporate Governance Regulations for Non-listed Companies

As discussed previously, the CGC has been issued by the CMA for listed companies only. However, another code of corporate governance was issued by the MoCI in 30 April 2018 for non-listed or closed joint stock companies within the Saudi market (MoCI, 2018a). This set of

regulations aims at providing non-listed companies with non-binding regulations to enhance their practices regarding accountability, transparency, and efficiency (Chehab, 2019). They are also intended to enhance the quality of practices that protect the interests of shareholders and other related parties (Aleqtisadiah, 2018). Non-listed companies are encouraged to follow such regulations which are intended to be complementary to the CA 2015. Nevertheless, the regulations published in the CA 2015 take precedence over the CG regulations whenever there is a conflict (Chehab, 2019).

This code has many similarities to the CGC 2017 in relation to several general practices concerning shareholders' rights and board of directors. It consists of nine main sections and 95 Articles. There are a number of objectives that are meant to be achieved by implementing these regulations such as: (i) providing a well-defined legal framework for CG; (ii) increasing shareholders activism within their investee firms; (iii) demonstrating board and committees' responsibilities; (iv) promoting integrity and transparency; and (v) providing an effective framework for dealing with conflicts of interest (MoCI, 2018a).

4.10 Conclusion

This chapter has presented and discussed the political, legal, cultural, economic, and CG frameworks in the kingdom of Saudi Arabia. The objective of this investigation was to explore the role of each aspect of the country that have negatively or positively influenced the CG practices within the Saudi market. Presenting such negative and positive impacts assist in developing the current systems to further protect investors interests and to enhance the legal requirements that may improve the disclosures and transparency practices in the country.

Chapter 5. Methodology

5.1 Introduction

This chapter presents an outline of the design of this research and elaborates on the methods applied to gather the data used to accomplish its objectives. According to Collis and Hussey (2009), a detailed strategy of a research design may help a researcher to monitor and concentrate on the research process. A research design describes all elements associated with the planning and accomplishing phases of a piece of work, starting with identifying the research problem and ending with the reporting of its results (Punch, 2005). Generally, its purpose is to organise the different processes involved in the research to reach its objectives (Easterby-Smith et al., 2002).

This chapter aims to accomplish two primary objectives. First, it addresses the underpinning theoretical assumptions of research design and methodology. Second, it demonstrates the methodology and methods employed for primary and secondary data collection. The chapter aims to present an appropriate research approach that assists in achieving the research objectives and answer its underlying questions. The subsequent sections of the chapter will present the following: (i) the philosophical assumptions of the research paradigms, (ii) the research design, and (iii) a demonstration of methods and data used in this research.

5.2 The Philosophical Assumptions of The Research Paradigms

5.2.1 The Philosophical Assumptions

This section demonstrates the underpinning philosophical assumptions and research paradigms. According to Saunders et al. (2016), research philosophy is defined as ‘a system of beliefs and assumptions about the development of knowledge’. Burrell and Morgan (1979) indicate that views of social science can be either subjective or objective which depends on four philosophic assumptions namely: ontology, epistemology, human nature, and methodology. Scholars claim that each assumption has two extremes called ‘subjectivism’ and ‘objectivism’ (see Figure 5.1).

According to Guba (1990), research is formed by paradigms in regard of ontology (reality), epistemology (knowledge) and methods of acquiring knowledge related to that reality (methodology). Therefore, it seems helpful for researchers to comprehend the distinct types of research philosophy because these assumptions could be influential during the different process of research such as research design, examining issues, data collection, methods selection and findings interpretation (Crotty, 1998; Bryman, 2012; Saunders et al., 2016). Hence, the selection of an appropriate research methodology cannot be made in isolation from the consideration of the four philosophical assumptions (Ryan et al., 2002). The following subsections discuss these assumptions.

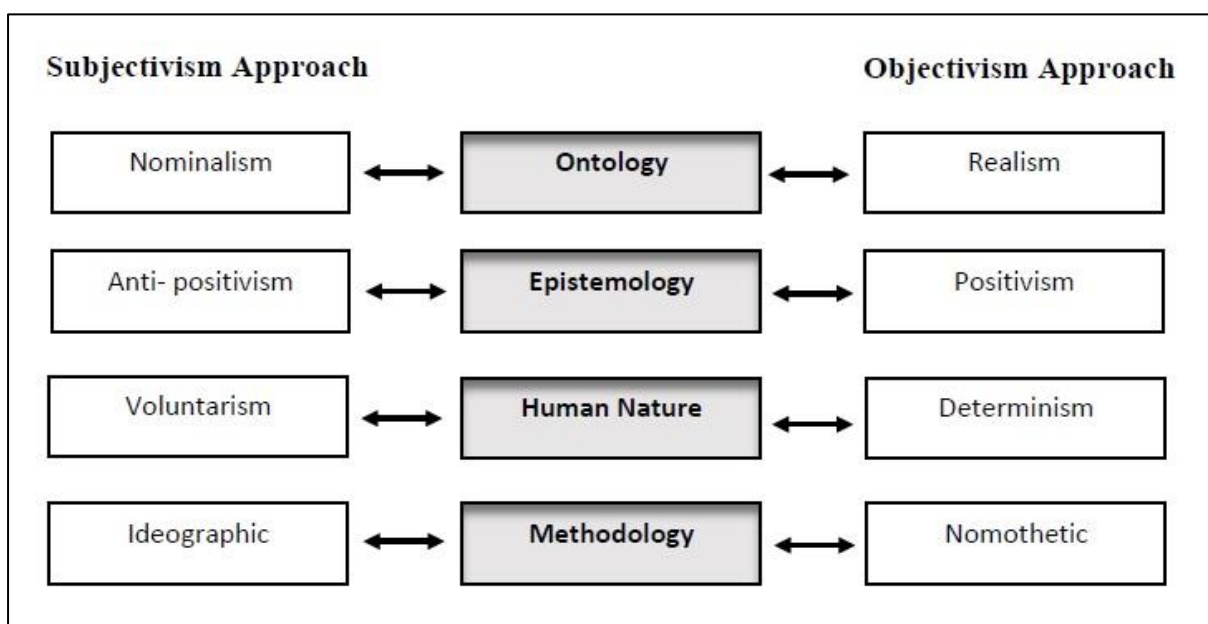


Figure 5.1: Subjectivism and Objectivism Approaches

Source: Burrell and Morgan (1979, p.3)

5.2.1.1 *Ontology*

Ontology is occasionally referred to the study of reality (Dillard, 1991; Crotty, 1998). A definition is presented by Blaikie (2000, p.8) that states ontology is ‘claims and assumptions that are made about the nature of social reality, what exists, what it looks like, what units make it up and how these units interact with each other. In short, ontological assumptions are concerned with what we believe constitutes social reality’. Burrell and Morgan (1979) indicate that the ontological assumption demonstrates views on the reality nature and examine its objectivity to ensure if certain phenomena is real or a part of an individual’s consciousness.

Burrell and Morgan (1979) suggest that there are two ontological stances namely: ‘Nominalist’ within the subjective dimension and ‘Realism’ within the objective dimension. Realism claims that reality is objective in nature, and its existence is independent of individuals. Knowledge of individuals of reality is basically a discovery of the objective reality. On the other hand, nominalism relates the world to a collection of perceptions and ideas that are created by social actors and used to describe reality (Saunders et al. 2007).

5.2.1.2 Epistemology

Crotty (1998, p. 3) defines epistemology as ‘a way of understanding and explaining how we know what we’. Epistemology is concerned with what is deemed an acceptable knowledge and how it is delivered to individuals (Bryman, 2004). In addition, Cooper et al. (1999, p.3) claim that ‘many people have the impression that epistemology is the most central area of philosophy, or even that philosophy should really be identified with epistemology. Certainly, there is a popular image of philosophers as people obsessively and almost solely concerned with determining whether we really know the things we ordinarily think we do’.

The epistemological assumption embraces two extremes namely: ‘Positivism’ and ‘Anti-positivism’. Positivism suggests that knowledge is hard and real, and independent of individuals consciousness. Researchers who embrace positivism views knowledge of social research as a construction of an accumulation of activities by observers investigating casual relationships (Dillard 1991, p. 11). Researchers following this approach intend to discover casual laws that enable them to predict general patterns in their research findings (Saunders et al., 2012; Neuman, 1997). The anti-positivism approach, however, leans toward the subjective stance in relation to examining the differences between individuals in society (Saunders et al., 2009). Via this approach, researchers reject the idea that knowledge exists independently of any consciousness. Instead, they follow certain methods such as observation and conducting interviews with individuals involved in the issue under examination (Hopper & Powell, 1985; Crotty, 1998). Therefore, finding general patterns or regularities of social phenomena is not a substantial issue (Saunders et al., 2007).

5.2.1.3 Human Nature

The third assumption is human nature which is referred to the nature of social science that considers the relationship between individuals and their surrounding environment. This

assumption suggests that assumptions can be constructed in relation to human nature based on understanding human interactions (Burrell and Morgan, 1979). The two extremes of human nature assumption are 'Determinism' and 'Voluntarism'. Determinism believes that the environment created human and their behaviour. In contrast, voluntarism views human beings as completely autonomous in creating their environment (Burrell and Morgan, 1979).

5.2.1.4 Methodology

The fourth philosophical assumption is methodology, which is linked to the process that assists researchers in determining the appropriate research paradigm (Hussey and Hussey, 1997). As shown in Figure 5.1, it has two extremes namely 'Nomothetic' and 'Ideographic'. Burrell and Morgan (1979) claims that the selection of ontological, epistemological and human nature assumptions enables researchers to adopt the appropriate methodology assumption. Researchers can adopt either the nomothetic or ideographic approaches. They are able to adopt both of approaches depending on the philosophical assumptions adopted earlier.

The ideographic approach of methodology is subjective in nature and concerned with the history of individual activities (Dillard, 1991). In other words, researchers study small populations and employ different research methods, such as interviews and field studies, to obtain different perceptions of the issue under investigation aiming to understand 'what is happening' (Hussey and Hussey, 1997; Saunders et al., 2007). The nomothetic approach, however, is objective in nature and based on seeking causality or relationships which requires large samples and using systematic quantitative techniques to analyse the social phenomena which is being examined (Burrell and Morgan, 1979; Dillard 1991).

In terms of this research, it benefits from subjectivism and objectivism in relation to the collection and analysis of data. This is due to the use of primary data through conducting semi-structured interviews, and secondary data that are collected via a number of sources such as annual reports. The former represents the subjectivism stance of this research as interviewees present their views on the social reality based on their own understanding. The latter is considered objective in nature. Hence, this research benefits from two different sample of data constructed and analysed by two different approaches.

5.2.2 Research Paradigms

Philosophers and scholars of social sciences created the term paradigm through the work of Thomas Kuhn which is named *The Structure of Scientific Revolutions* (1962). Collis and Hussey (2009) define a research paradigm as “a framework that guides how research should be conducted, based on people’s philosophies and their assumptions about the world and the nature of knowledge” (2009, p.55). A paradigm is deemed useful in guiding researchers to understand and explain social phenomena which is based on the ontological and epistemology positions (discussed earlier) (Saunders et al., 2007). According to Burrell and Morgan (1982) (as cited in Saunders et al., 2012), there are three purposes of paradigms. First, a paradigm assists researchers in sharpening their philosophic assumptions of their views of the social phenomena. Second, it clarifies the approach adopted in the work conducted by researchers. Third, a paradigm is helpful to researchers in planning and realising the extent of their research.

Two main research paradigms have developed: positivism and interpretivism, which are widely employed by management researchers (Bryman, 2012). Positivism focuses on the view that realism is the base of the nature of knowledge. On the contrary, interpretivism asserts that the base of the nature of knowledge is idealism and exploring the explanation of social events. Details of both paradigms are presented in the next two sections.

5.2.2.1 Positivism

In the late eighteenth century, the positivism paradigm had emerged through the work of a number of positivists namely: August Comte, Mill, Durkheim and Locke (Creswell, 2009). Such scholars claim that reality is not dominated by social norms and assumptions, and they build up theories that depend on empirical work including observation and experimentation (Hesse-Biber and Leavy, 2011). Positivism is deemed to produce knowledge that depends on the logic of science and statistical evidence (Walliman, 2005). In addition, Collis and Hussey (2009, p.56) describe positivism in business studies by stating: “Today, researchers conducting business research under a paradigm that stems from positivism still focus on theories to explain and/or predict social phenomena”. Hence, scientists who support the view of positivism believe in the logical thinking and neutrality supported by proofs and observations rather than subjectivity and instinctive analyses.

Positivists examine causal associations between different variables that may play an effective role in developing theories from the results. Additionally, they support the view that claims that measurement of social phenomena is achievable, therefore, interpreting such phenomena through quantitative methods is possible too (Bryman, 2012; Saunders et al., 2007). Moreover, the work of Creswell and Clark (2011) finds that scholars may relate to knowledge on the basis of: (1) determinism, (2) reductionism, by concentrating on choosing variables that are relatable, and (3) comprehensive observations and measurement of those variables. Given this, the positivism paradigm is employed in the current research to investigate the relationship between CG mechanisms and major shareholdings in the context of the Saudi capital market.

5.2.2.2 Interpretivism

The emergence of the interpretivism paradigm was based on the notion of idealism and subjective social reality. Thus, discussions of social phenomena mainly depended on subjectivity and formed based on the perceptions of individuals (Morgan and Smircich, 1980; Collis & Hussey, 2009). In the late nineteenth century, this paradigm had received a remarkable attention which led several scholars, such as Dilthey, Weber and Kant, to support interpretivism, and start opposing the old and traditional positivism paradigm (Creswell, 1994).

It is claimed that interpretivism had emerged as a result of the inability of the positivism paradigm to offer social scientists with their needs in regard of measurement of social phenomena (Morgan and Smircich, 1980; Collis and Hussey, 2009). They presented new ideas about the interpretive paradigm which are: (1) people are never separated from their social contexts, (2) people are only understood if their views on their practices are investigated, (3) structures of research designs that are too sophisticated can undermine relevant variables, (4) research should be free of objectivity, (5) measuring complicated social phenomena with one dimension is misleading. Given this, the interpretivism paradigm is believed to offer opportunities to discover new ways of research in social science.

Table 5.1, Panel A shows the common terms used to describe the two paradigms. Panel B provides a list of the features of each paradigm such as hypotheses, sample, theories involved and data.

| Panel A: Common terms used to describe the paradigms | |
|--------------------------------------------------------------------|---------------------------------------------------------------------|
| Positivism | Interpretivism |
| Quantitative | Qualitative |
| Objective | Subjective |
| Scientific | Humanist |
| Traditionalist | Phenomenological |
| Panel B: Features of the paradigms | |
| Positivism | Interpretivism |
| Large sample is involved | Used with small samples |
| Concerned with hypothesis testing | Helpful in generating theories |
| Produces precise, objective, and quantitative data | Produces ‘rich’ subjective and qualitative data |
| Produces results with high reliability but low validity | Produces findings with low reliability but high validity |
| Allows results to be generalised from the sample to the population | All findings can be generalised from one setting to another setting |

Table 5.1: Approaches within the two main paradigms

Source: Collis and Hussey (2009, pp.58, 62).

Furthermore, Bryman (2012) argues that positivists tend to concentrate on measuring social events while interpretivism focus on examining the complexity of such social phenomena to form a new understanding. Thus, interpretivism leans towards exploring, interpreting, and increasing the extent of understanding to clearly expose the meaning of terms (Creswell and Clark, 2011). The interpretivism paradigm is not concerned with the quantitative approaches of social phenomena that provide statistical evidence in the social science. Instead, this paradigm relates to the qualitative measures. This research conducts semi-structured interviews as well as statistical tests using quantitative secondary data. Hence, semi-structured interviews may support quantitative methods with additional evidence on the issue being addressed, which enhances joint findings of both approaches (Saunders et al., 2007), and provide a deeper understanding of the empirical findings (Saunders et al., 2007; Boyd et al., 2012).

5.2.3 Research Methodologies

The literature has several definitions of research methods, but one of the most direct definitions is ‘the strategy of enquiry’ (Mayers 2013, p.153). In general, research methods are involved with the building of the research, the way of obtaining data, and how contribution is made.

Considering the two philosophical paradigms discussed in the previous section, there are three research approaches that researchers can select to accomplish their research in social sciences, which are quantitative, qualitative, and mixed methods (Veal 2005; Saunders, Lewis and Thornhill 2012). Each approach requires certain procedures, techniques, and methods. The nature of the research problem and data determine which method is appropriate for accomplishing the research (Collis and Hussey, 2003; Alshehri, 2012).

5.2.3.1 Quantitative Approach

Collis and Hussey (2003) presented a concise explanation of the quantitative method involving the compilation and analysis of numerical data, and then the application of statistical tests. The key concept of quantitative research is to construct theory blocks which reflect the points around which social research is carried out (Bryman, 2012). Techniques used in quantitative research share positivism-based language and logical forms which distinguish them from qualitative research methods (Collis and Hussey, 2003; Neuman, 2006; Alshehri, 2012). Quantitative analysis makes it possible for the researcher to become familiar with the question or idea to be examined and then to create hypotheses to be tested (Golafshani, 2003). The key challenges of the quantitative approach are to construct and create a causal association between two or more variables and to forecast or demonstrate the relationship between different variables (Creswell, 2007; Alshehri, 2012). Bryman (2012) confirmed that quantitative science can be described as a research approach that stresses data collection quantification and data interpretation.

According to Denscombe (2007), using quantitative methods may feature positive and negative aspects to the research. The positive aspects include (i) using quantitative data employs objective rules that generate a scientific analysis, (ii) credible analysis is provided by quantitative data, (iii) the analysis of quantitative examinations presents a solid base for the research, and (iv) quantitative is not time-consuming as long as a proper planning and administration have taken place prior the commencement of research. In contrast, Denscombe (2007) that there are also disadvantages of employing quantitative methods such as (i) the usage of quantitative research is restricted to its relevant problem, (ii) the researcher attention may be diverted when more focused is given to the technique of quantitative analysis, (iii) using a large

volume of statistical data may turn the research to be too complicated, and (iv) far-reaching effects on the findings might occur on the decisions made throughout the analysis.

5.2.3.2 *Qualitative Approach*

According to Collis and Hussey (2003), qualitative methods is defined as a subjective method that provides analysis of perceptions aiming at demonstrating phenomena. Another definition of qualitative research is indicated by Sandelowski (2004, p. 893) as ‘an umbrella term for an array of attitudes toward and strategies for conducting inquiry that are aimed at discovering how human beings understand, experience, interpret, and produce the social world’. The process of qualitative methods usually involves exploring topics and discovering phenomena, which are mostly connected to the researcher’s subjective interpretation (Veal, 2005).

The qualitative approach has positive and negative aspects. Denscombe (2007) states that positive aspects include (i) employed data and analysis are grounded, (ii) the data is characterised with richness and depth, (iii) ambiguity and contradictions are allowed, and (iv) different interpretations are possible. However, using qualitative methods may cause some flaws to research such as (i) the representation level of used data can be limited, (ii) the researcher values may interfere in the analysis phase, (iii) data can be taken out of context, (iv) explanations can be overgeneralised, and (v) analysing qualitative data is time-consuming. Table 5.2 provides a summary comparison between quantitative and qualitative research.

| | Qualitative Research | Quantitative Research |
|------------------------|-----------------------------------------------------------------------------|-----------------------------------------------------------------------------------------------|
| Objective | To obtain a qualitative understanding of underlying reasons and motivations | To quantify the data and generalise the results from the sample to the population of interest |
| Sample | Small number of nonrepresentative cases | Large number of representative cases |
| Data collection | Unstructured | Structured |
| Data analysis | Non-statistical | Statistical |
| Outcome | Develop an initial understanding | Recommend a final course of action |

Table 5.2: Comparison between Quantitative and Qualitative Research

Sources: Adapted from Malhotra (1993)

5.2.3.3 *Mixed Methods Approach*

Mixed methods research has become popular in the field of CG (Al-Saidi, 2012; Alshehri, 2012; Alghamdi, 2012). The term used for employing mixed methods is triangulation which is defined as ‘the use of two or more independent sources of data or data-collection methods within one study in order to help ensure that the data are telling you what you think they are telling you’ (Saunders et al., 2012, p. 683). The use of mixed methods in a single research enables the researcher to overcome potential obstacles that a mono-method research may encounter (Collis and Hussey, 2003). It is argued that the motive for employing mixed methods is that qualitative data, interviews for instance, features more comprehension of the research problem, however, the data is obtained from a limited number of sources (interviewees) (Crowther and Lancaster, 2009).

According to Bryman (2006); Greene et al. (1989); Molina-Azorin (2011) (as cited in Saunders et al., 2012), there are various incentives to employ mixed methods such as (i) enabling the elaboration, clarification and linkage of meanings and results; (ii) The results of one method can be utilised to explain the results of the other method; (iii) obtaining greater diversity of views; (iv) The results of one method may offset the limitations of the other method; (v) elevating the credibility of the research; and (vi) one method can be employed for certain research questions while the other method focuses on different research questions.

There are three principles that are suggested by Creswell and Clark (2011) for designing a mixed-method research. The first principle is the level of interaction between the qualitative and quantitative approaches. They identify two levels of interaction namely: the independent and the interactive levels. The independent level is concerned with identifying the quantitative and qualitative research methods employed for each of the research questions as well as acknowledging the process of data collection and analysis. This level is based on combining both quantitative and qualitative methods in the research conclusion. The interactive level, however, exists when one research method relies on the other, especially in relation to data collection and analysis.

The second principle for designing a mixed-method research is ensuring that the researcher appropriately identify the research methods that enable him/her to achieve research objectives (Morgan, 1998). Under this principle, the researcher is expected to specify the importance level of each research method. The importance of the research methods is estimated based on three

levels: equal priority, quantitative priority, and qualitative priority (Creswell and Clark, 2011). The third key principle is linked to the timescale of the study. There are three types of research timescale namely: concurrent, sequential or a multi-phase combination.

Due to the nature of this thesis questions and objectives, the quantitative method is given the focus at the initial stage. To investigate the impact of CG on major shareholdings in the Saudi capital market, this approach is expected to provide more clues at this stage. In addition, this thesis uses both quantitative and qualitative methods at the independent level by performing quantitative examinations and obtaining interpretations from the subsequent qualitative method. Therefore, by performing quantitative examination at the initial stage, this research follows the sequential type of research timescale.

Moreover, recognising the importance of the design of a mixed-method research is substantially linked to the framework of this thesis. According to Creswell and Clark (2011), there are four core designs for a mixed-method research namely: (i) the convergent parallel design; (ii) the explanatory sequential design; (iii) the exploratory sequential design; and (iv) the embedded design. The convergent parallel design exists when the researcher performs both quantitative and qualitative methods at the same time. The researcher employs both methods independently throughout the data collection and analysis phases, which is eventually followed by an integration of the findings to present overall interpretations. The explanatory sequential design is constructed by following a sequential timescale that begins with performing quantitative investigations followed by qualitative investigations in order to interpret the former's empirical findings. For instance, researchers may conduct interviews to assist in understanding and interpreting the results of the quantitative investigations (e.g., Haniffa and Hudaib, 2007; Johl et al., 2012).

The third design is the exploratory sequential design, which is basically constructed quite the reverse to the explanatory sequential design. The researcher following this design performs qualitative methods at the initial stage of the research followed by the quantitative method. The fourth and last design is the embedded design which is based on the addition of one method as a part of the other. For instance, adding a quantitative method to a qualitative method as in case studies. The same also applies if the researcher adds a qualitative method to a quantitative one as in experiments.

For the current thesis, the researcher uses the second design which is the explanatory sequential design. The selection of this design is linked to three reasons. First, employing a qualitative

method helps in gaining additional insights on the issues under investigation (Boyd et al., 2012; Molina-Azorin, 2012). Second, the robustness of the empirical results of the quantitative examinations is intended to be increased by the results of the qualitative method (Mengoli et al., 2009). Third, this design seeks to explore CG reforms that are not obtained through quantitative examinations (Mengoli et al., 2009).

Given the above, this thesis employs this design by following two procedures. The first procedure is to perform a quantitative method involving data collection and analysis followed by the second procedure which is identifying the significant findings that need additional interpretations (see Mengoli et al., 2009; Johl et al., 2012). These two procedures assist in constructing the qualitative method and data that are needed to be obtained. In other words, some quantitative findings assist the researcher in designing the semi-structured interview questions, focus and process.

5.3 Research Methods and Design

5.3.1 The Quantitative Method

Quantitative methods usually use secondary data obtained from existing sources. In this case, researchers do not obtain information from respondents or interviewees, but they only have to collect such data from reliable sources (Cooper & Schindler, 2013). However, secondary data can sometimes suffer from a number of limitations such as lack of control, incompleteness and inappropriateness. Such limitations may lead to incomplete answers to research questions (Denscombe, 2008; Saunders, Lewis, & Thornhill, 2012). Nevertheless, secondary data is noticeably less time-consuming (Murthy & Bhojanna 2008) and is considerably insightful in terms of examining economic and social fluctuations in the long run (Zikmund et al. 2013). This research adopts panel data analysis/multiple regression analysis as a mean of quantitative testing of the secondary data collected for the purpose of examining the impact of CG structure of potential investee firms on the selection of shares of major shareholders within the Saudi capital market.

The following sub-sections present sample, data sources, categories of major shareholders, selection of corporate governance mechanisms, selection of control variables, and specifications of the regression model of this research.

5.3.1.1 Sample and Data Sources

The sample used to examine the impact of CG structure of potential investee companies on choices of shares of major shareholders is selected from listed companies in the Saudi capital market. The reason behind selecting only listed companies is that the disclosure and availability of data for listed and not listed companies are not the same. The total population of the sample is 97 companies which represents a total of 485 observations of balanced data from non-financial companies in the Saudi capital market. In order to properly perform the quantitative assessment of this research, a number of listed companies were excluded from the selected sample: (i) delisted companies during the period of testing; (ii) companies with incomplete financial and CG data; and (iii) financial firms, such as banks as they implement different CG regulations issued by SAMA. Following these criteria helps meeting the requirements of balanced panel data analysis (Henry, 2008; Ntim et al., 2012a). Balanced panel data can provide the research with both cross-sectional and time-series observations. It can enhance degrees of freedom and reduce the effect of multicollinearity problems (Gujarati, 2003; Ntim et al., 2012a). Also, it helps detecting any cross-sectional relationships between CG mechanisms, control variables and major shareholdings over the five-year period (Ntim et al., 2012b). Finally, it helps reducing the potential endogeneity problems that may occur because of potential unobserved firm-level heterogeneity (Henry, 2008; Guest, 2009; Ntim et al., 2012b).

Data were collected for a five-year period from 2013 to 2017. The period selection allows the research to examine the impact of CG on the different categories of major shareholders over a number of years. The decision of the period selection is justified by three reasons: (i) the last modification made to the CGC 2006 was in 2012, effective from 1st January 2013 (CMA, 2014); (ii) no scandals or economic crashes have occurred during the selected period, which may have an impact on the results and interpretations of this research; and (iii) no major changes have been made to the Saudi CGC 2006 throughout the examined period except of the issuance of the CGC 2017, effective from 1st January 2018 (out of research scope).

The secondary data of this research were collected from three different sources: (i) firms' annual reports; (ii) DataStream software; and (iii) Bloomberg Database (see Appendix C for full details). To examine the effect of CG on the investment decisions of major shareholders, specific types of data were collected: (i) total major shareholdings of total shareholdings of

firms; (iii) major shareholdings of different categories of major shareholders; (iii) CG variables including a crafted CG score and board quality; and (iv) control variables (see Appendix D for variables measurement). The following sections demonstrate these types of data.

5.3.1.2 Categories of Major Shareholders

Prior studies have revealed that major shareholders adopt different characteristics in term of their beliefs, skills, or interests (Cronqvist and Fahlenbrach, 2009). Therefore, this research intends to extend to the literature by investigating the CG interests of different categories of major shareholders within the Saudi capital market. Previous researchers have shown that there are important implications to institutional investors identity due to accountable for distinct goals and behaviour such fiduciary responsibility or political agendas (Bushee, 1998; Bushee et al., 2010). As a result, it is deemed important to examine categories of major shareholders separately to extract their different preferences. For instance, Giannetti and Simonov (2006) investigated whether shares selection process of investors is affected by the quality of CG and made a distinction between two categories of investors: investors targeting private benefits and investors targeting security benefits. The study has revealed that investors targeting security benefits (institutional or small investors) probably avoid investing in poorly-governed firms. On the other hand, investors targeting private benefits seemed to invest in poorly-governed firms. In addition, Kim et al. (2010) have shown that different categories of investors (i.e., foreign and local investors) have distinct approached of share valuation regarding CG.

Furthermore, a distinction has been placed between independent and grey investors by Ferreira and Matos (2008). The study revealed that independent investors compared to grey investors tend to focus more on shares in markets that have a better legal system. However, the study indicated that both categories share mutual preferences in term of CG. Moreover, Chung and Zhang (2011) investigate CG preferences of different categories of institutional investors and concluded that all categories' shareholdings are positively related to CG; however, the significance of such relationships differ among the examined categories. Given this, it is noted that distinct categories of major shareholders may embrace different investment objectives and philosophies, especially in regard to CG. Nevertheless, many of such studies have differentiate between different types of only institutional investors. Therefore, it seems there is a lack in the literature that focuses on other categories of major investors.

Through the data collection phase of this research, the researcher reported the types of major shareholders that substantially exist in the Saudi capital market with no overlapping among the types. The types are family-owned firms (MAJOR1), governmental institutions (MAJOR2), other institutional investors not included in the other categories (MAJOR3), financial firms (MAJOR4), wealthy individuals (MAJOR5), funds and insurance firms (MAJOR6), inside shareholders or affiliations (MAJOR7), members of the Royal family (MAJOR8). The research had also obtained the total value and percentages of ownerships of these major shareholders categories of the sample selected for this research. Therefore, the researcher uses the aggregate shareholdings of these categories as the dependant variable in the examination of their relationship to CG and its impact on their stock choices. The percentage here represents the fraction of shares owned by major shareholders out of total shareholdings of their investee firms. Furthermore, the researcher examined the impact of CG on each category of major shareholders separately. The main source for major shareholders data is Bloomberg Database. The researcher also used firms' annual reports to ensure the accuracy of collected data where available.

5.3.1.3 Selection of Corporate Governance Mechanisms

By reviewing prior research, it is found that there are common CG mechanisms employed within investigations concerning CG such as board quality (e.g., Black et al., 2012; Black et al., 2003, Florou and Galarniotis, 2007, Klapper and Love, 2002, and Cornelius, 2005), shareholders rights (Ananchotikul 2008, Gompers et al., 2003; Price et al., 2011), and accountability (e.g., Black et al., 2012; Klapper and Love, 2002; Price et al., 2011). These mechanisms are deemed as means for a good running of firms. Therefore, this thesis uses two sets of CG provisions as independent variables, which are included in the CGC 2006. The first set is a crafted score consisting of provisions that are more related to shareholders rights, such as rights related to the general assembly, voting rights and other policies forming their relationship with the board (see Appendix B). If a company adopts the item, a score of 1 is given and 0 otherwise. Then we sum all scores for each company and then divide it by the number of items.

In relation to the provisions of shareholders rights, a significant part of the CGC 2006 is devoted for such regulations (see Appendix F). Almajid (2008) claims that in order to achieve good CG practices, it is necessary to focus on protecting the rights of shareholders. The ability of countries to attract investors, for example foreign investors, is associated to the quality of CG practices, especially in relation to investors rights and interests. Shareholders' rights are a fundamental aspect of CG practices. According to a report issued by World Bank, Saudi Arabia is ranked 17 out of 183 countries in relation to the protection of investors. It is argued that several international examples of good practices related to shareholders' rights are absent in the CGC 2006 (Alkahtani, 2013). This inspires this research to draw attention to the impact of such provisions as there are concerns of the quality of shareholders rights in developing markets especially in Saudi Arabia (Alkahtani, 2015). In addition, prior studies have shown that major shareholders unfairly treat or oppress minority shareholders within the Saudi capital market (Alhabshan, 2015; Alkahtani, 2015; Alfordy, 2016). Major shareholders are accused of practicing some form of expropriation against minority shareholders (Alkahtani, 2015). However, Akeel (2018) provided an evidence that minority shareholders rights are fairly protected in the presence of major shareholders.

This raises the question of whether major shareholders prefer such mechanisms implemented in potential investee firms to practice their dominance as claimed by the above studies, or they embrace different perceptions toward them. Therefore, this research uses a crafted CG score consisting of provisions that are more related to shareholders rights, such as rights related to the general assembly, voting rights and other policies forming their relationship with the board (see Appendix B). This thesis examines mechanisms of shareholders rights by both quantitative and qualitative methods.

Regarding mechanisms of board quality, five board characteristics (board quality) are employed in the quantitative assessment of this research. They are size, independence, Non-Executive Directors (NEDs), annual meetings, and royal members. In regard to board size, the CGC 2006 states that listed firm should form boards of 3 to 11 members only. Therefore, this thesis measures board size based on the number of board members as of 31st December of each year. According to Hermalin and Weisbach (2003), small boards can be more effective than larger boards. It is argued that large boards are incapable of monitoring and controlling the agency problem (Lasfer, 2006). Board independence is deemed as a fundamental part of CG practices (Dahya et al., 2008). The CGC 2006 indicates that the majority of board members has

to be non-executive with the requirement that at least two or a third of board members are independent, therefore, the independence level of firms is included in this set of CG mechanisms and calculated based on the number of independent members in the board as of 31st December of each year.

Additionally, this set includes the number of annual board meetings of listed firms in each fiscal year, which is a mechanism that assists in enhancing communication between managers and directors. Brick and Chidambaram (2007) revealed that board meetings are positively linked to firm value and showed that more board meetings reflect better monitoring practices. Vafeas (1999) also supports such a conclusion by stating that the frequency of board meetings can be utilised as a tool for strategic governance. The CGC 2006 requires listed firms to meet on a regular basis with no specification of the frequency of meetings. The last mechanism added to this set is the presence of members of the royal family in boards, which is one of the unique characteristics of the Saudi capital market. This research computes this variable based on the number of royal individuals as board members as of 31st December of each year in the sample. It is claimed that due to the dominance power that the government exercise on the kingdoms policies, many members of the royal family became widely involved within the capital market through their private and semi-public companies (Al-Rasheed, 2010). To examine whether their presence affects the investment decision of major shareholders, this characteristic of boards is employed in the quantitative assessment of this research. A summary of the measurement of CG variables is presented in Appendix D.

5.3.1.4 Selection of Control Variables

A number of studies have used different control variables in their examinations of corporate governance issues. This research uses nine variables including: firm size, leverage, share turnover, dividend yield, profitability (ROA), firm value (Tobin's Q), stock return, share price, and firm age. This selection of control variables is based on prior research of investors' preference in investee firms. To begin with, firm size is recognised as a preferred characteristic to investors as they tend to invest in large firms according to Aggarwal et al. (2005) and Gompers and Metrick (2001). This research measures firm size as their market value as of year-end. To control for the risk level of a firm, firm leverage is calculated as the percentage of total

debt to total assets whereas share turnover is computed based on the annual share volume divided by adjusted shares outstanding (number of shares outstanding/adjustment factor). The selection of this variable is based on the work of Chung and Zhang (2011) and Elkinawy (2005) where the latter showed that investors gravitate to low levels of leverage.

In addition, Jain (2007) showed that institutional investors tend to buy shares with low dividend yield, however, other shareholders prefer shares with high dividend yield. Therefore, dividend yield has been selected as a control variable in this research and is measured by the dividends per share to market price year-end. Moreover, Huang (2008) and Elkinawy (2005) revealed that fund managers tend noticeably to invest in liquid stock. This promotes the importance of choosing shares turnover as one of the control variables to be used. Share turnover is computed based on the annual share volume divided by adjusted shares outstanding (number of shares outstanding/adjustment factor). According to Kim et al. (2010), investors are attracted to companies that produce higher Tobin's Q and higher ROA, therefore, profitability and firm value are included and measured by these indicators as in Chung and Zhang (2011). In this research, ROA refers to yearly return on assets of each firm included in the sample whereas Tobin's Q is basically the sum of total assets plus market value of equity minus book value of equity divided by total assets.

Furthermore, Ferreira and Matos (2008) have shown that independent institutions and foreign investors always chase firms with positive stock return performance, hence, this research uses it as a control variable too. Share return is calculated as the appreciation in the price divided by the original price of the stock. Share price refers to market price as of 31st December of each year (in Saudi Riyal). Finally, firm age is computed based on the firm's establishment date (YEARS).

It is worth noting that the sources used to obtain the full data of control variables are DataStream, Bloomberg and Tadawul (the Saudi capital market website). A summary of the measurement of control variables is presented in Appendix D.

5.3.1.5 Regression Models

Given the data discussed in the previous sections, the main objectives as well as other variables included in the discussions are employed in a multiple regression model to examine the impact of CG structure of potential investee firms on the shares choice of major shareholders in the Saudi capital market. This research uses ten models to achieve its objectives. A list of employed regressions models is presented in Table 5.3.

| Model | Explanation |
|-----------------|-------------------------------------------------------------------------------------------------------|
| Panel A: | |
| Model 1 | Pooled Regression model consisting of all categories of major shareholders |
| Model 2 | Pooled Regression model of all categories of major shareholders except of MAJOR1 (non-family sample). |
| Panel B: | |
| Model 5 | Pooled Regression model of wealthy families' major shareholdings (MAJOR1) |
| Model 6 | Pooled Regression model of governmental major shareholdings (MAJOR2) |
| Model 7 | Pooled Regression model of other firms' major shareholdings (MAJOR3) |
| Model 8 | Pooled Regression model of financial firms' major shareholdings (MAJOR4) |
| Model 9 | Pooled Regression model of wealthy individuals' major shareholdings (MAJOR5) |
| Model 10 | Pooled Regression model of insurance & funds major shareholdings (MAJOR6) |
| Model 11 | Pooled Regression model of managerial/Insider major shareholdings (MAJOR7) |
| Model 12 | Pooled Regression model of royal major shareholdings (MAJOR8) |

Table 5.3: Regression Models

To begin with, the regression model format is as follows:

$$\begin{aligned} \text{MAJORHOLD}_{it} = & \beta_0 + \beta_1 \text{CGSCORE}_{it} + \beta_2 \text{BODSIZE}_{it} + \beta_3 \text{BODINDP}_{it} + \beta_4 \text{BODNEDS}_{it} \\ & + \beta_5 \text{BODMEET}_{it} + \beta_6 \text{BODROYAL}_{it} + \beta_7 \text{FSIZE}_{it} + \beta_8 \text{FLEV}_{it} + \beta_9 \text{FTURN}_{it} + \beta_{10} \text{FDY}_{it} + \\ & \beta_{11} \text{FROA}_{it} + \beta_{12} \text{FTOBIN}_{it} + \beta_{13} \text{FRETURN}_{it} + \beta_{14} \text{FPRICE}_{it} + \beta_{15} \text{FAGE}_{it} + \varepsilon \end{aligned}$$

We measure company i 's major shareholdings in year t (MAJORHOLD $_{i,t}$) by the ratio of the number of shares owned by major shareholders to the total number of shares outstanding. Our CG provisions, that we collected from annual reports for this research, are referred to as CGSCORE $_{i,t}$. Board quality is measured by five of its characteristics namely: size (BODSIZE $_{i,t}$), independence (BODINDP $_{i,t}$), NEDs (BODNEDS $_{i,t}$), meetings (BODMEET $_{i,t}$), and royal membership (BODROYAL $_{i,t}$). We also calculated the control variables selected for this research and referred to as: the firm size (FSIZE $_{i,t}$), leverage (FLEV $_{i,t}$), share turnover (FTURN $_{i,t}$), dividend yield (FDY $_{i,t}$), the ratio of net income to the book value of total assets (FROA $_{i,t}$), Tobin's q ratio (FTOBIN $_{i,t}$), the annual (end-of-year) geometric stock rate of return (FRETURN $_{i,t}$), share price as of end-year (FPRICE $_{i,t}$), and finally firm's age (FAGE $_{i,t}$). β_0 is the intercept and ε is the error term (See Appendix D for full details of variables measurement).

This model is also used to investigate the interests of different types of major shareholders in CG by replacing MAJORHOLD with the percentage held by each category of major shareholders (Table 5.3, Panel B). In addition, this model is re-estimated by using the preferences (variables) revealed through the semi-structured interviews conducted with a sample of major shareholders.

Furthermore, some interesting results have derived the researcher to further explore the issue. Prior literature has examined the role of wealthy families in the Saudi market and how they can have an impact on the general atmosphere of the market due to their large capitals. Al-Assaf et al. (2017) have examined the CG practices in the family-owned businesses in Saudi Arabia and found that most of these firms prefer to follow conservative, traditional and weak CG guidelines. The study continued reporting that such firms are inactive in regard of their role as influential players in the market. Given this, it seems that family-owned firms have no preference in engaging in CG issues and would not favour them when they act as investors too.

Moreover, Aleshaikh (2018) discussed the fact that some major shareholders in the Saudi capital market, especially families, may cause an unbalanced board composition in some firms. For instance, a family block-holder with 20% of Zamil Industrial Investment Company shares was the one who nominated 40% of the company's board members. The author argues that even though some family-owned firms hold less than 50% of investee firms but they still have control over their practices in a way that is in their benefit. In other word, they would not

appoint independent or non-executive members unless they are linked to them in a beneficial way.

Besides, Alsanosi (2010) states that since family businesses existed a long time prior to the establishment of the Saudi capital market, they had the opportunity to become large firms especially by following the route of Initial Public Offering (IPO) to get listed in the capital market. Therefore, large holdings were owned by families. This has led families to hold a power to lobby governmental institutions and authorities for preferential dealing and assignment of contracts, which eventually is expected to have an impact on the legal system in the country. Given this, the nature of the relationship between family major shareholdings and CG in the Saudi capital market is clearer.

Because of such argument, the total sample of major shareholdings has excluded major shareholdings of wealthy families (Non-Family Sample) (Table 5.3, Panel A, Model 2).

5.3.2 The Qualitative Method

The qualitative method is intended to identify CG aspects that may or may not have an impact on shares selection of major investors in the Saudi capital market. The motive for using this method is that the researcher intends to have a feeling of what major shareholders care about in CG practices and figure out what they actually consider when planning to purchase shares in listed companies. Also, this method is employed in this research to complement the quantitative method explained earlier attempting to cover unavailable secondary data as well as to explain regression analysis results. Even though primary data requires a long time, specific skills, and encountering restrictions on the accessibility to information, but it enables the researcher to gain new insights and discover current phenomena (Sekaran and Bougie, 2013; Bajpai, 2011).

According to Saunders, Lewis and Thornhill (2007) and King (2006), interviews are noticeably useful when used in qualitative research as they can help concentrating on specific points and understanding the relationships between variables (See Table 5.3). As a result, the researcher has decided to use interviews for collecting primary data for this research.

5.3.2.1 Interviews

The interview is regarded as one of the major tools for data collection in qualitative research (Gilbert, 2008). Nevertheless, this tool can also be employed in quantitative research (Punch, 2005). An interview is widely defined as ‘a conversation with purpose’ (Berg, 2007, p. 66). Interviews are basically beneficial discussions between two or more people that can assist researchers to collect valid and genuine information concerning the issues addressed (Saunders, Lewis and Thornhill, 2007).

There are three different types of interviews that are used in social sciences research namely: structured, unstructured, and semi-structured interviews (Collis and Hussey, 2009; Silverman, 2011). Structured interviews are a set of fixed questions formed in a standardised order. This type of interviews is primarily employed in quantitative research (Saunders, Lewis and Thornhill, 2009). The flow of structured interviews is not flexible, and the research usually is unable to deviate from the fixed questions or expand the discussion on relevant issues (Patton, 1990). In contrast, unstructured interviews are more flexible and enable the researcher to develop the discussion during the interview with no prior preparations. The researcher during unstructured interviews has no control over the discussed topics (Collis and Hussey, 2009).

Semi-structured interviews, however, are less flexible than unstructured interview but more flexible than structured interviews. Semi-structured interviews are broadly utilised to gain an in-depth understanding. Researchers conduct semi-structured interviews by using pre-designed and open-ended question to allow more relevant questions to be brought up during the interview (Rubin and Rubin, 1995). Interviewers usually involve the same key questions in all interviews; however, their sequence may get changed based on the flow of the interview (Gilbert, 2008).

According to Warwick and Lininger (1975), Hoinville and Jowell (1985) and Adams and Schvaneveldt (1985), several advantages can be gained from conducting semi-structured interviews in research. First, the researcher can manage the interview flow which can lead to a higher response rate comparing to mailed questionnaires. Second, the interviewer can do more search to gain more questions and data on the issue being addressed. Third, the non-verbal behaviour of interviewees can be examined by the interviewer. Fourth, the enjoyment of speaking is a widely spread habit among people, which can be useful for acquiring more data via interviews. The last advantage is that semi-structured interviews are more flexible in terms

of asking long or complicated open-ended questions. Nonetheless, interviews have some disadvantages such as: higher cost than other methods, the interviewer's personal effect can interfere, and anonymity may be limited especially when critical issues are being addressed (Frankfort-Nachmias and Nachmias, 2008, Collis and Hussey, 2009).

The researcher selected semi-structured interviews as a qualitative method for this thesis for four reasons. First, semi-structured interviews are conducted to gain deep comprehension of CG issues (e.g., Haniffa and Hudaib, 2007; Liew, 2007; Johl et al., 2012; Piesse et al., 2012; Soobaroyen and Mahadeo (2012); Bailey and Peck, 2013). Second, prior research indicates that there is a linkage between CG system and political, legal, and economic systems (La Porta et al., 1997; Klapper and Love, 2004; Aguilera and Cuervo-Cazurra, 2009) and semi-structured interviews is a useful tool to analyse such linkage between CG system and other systems. Third, semi-structured interviews grant a thorough understanding of both motives and obstacles to CG reforms. Finally, by conducting semi-structured interviews, the researcher becomes able to evaluate the reliability of interviews outcome (Humphrey and Lee, 2004). Hence, the semi-structured interviews approach is a more appropriate type of interviews that can be used to examine CG topics in details (Liew, 2007, Piesse, Strage and Toonsi, 2012; Bailey and Peck, 2013).

5.3.2.2 *Interview Design and Guide*

A semi-structured interview guide is useful to manage research questions in semi-structured interviews (Corbin and Strauss, 2008). This research follows Gilbert (2008) approach in designing the interview guide which is based on three procedures to be executed. The procedures are specifying the interview themes, generating interview questions, and evaluating the semi-structured interview guide. Hence, the researcher has created a semi-structured interview guide that contains a brief list of topics with relevant questions that have to be covered during interviews. The two main sources of these topics and questions are the literature of the relationship between CG and major shareholders in both developed and developing markets as well as the research questions of this thesis.

Regarding the determination of the interview themes, the guide has five broad topics, namely; understanding of CG and its importance; the assessment of CG mechanisms; the role of major shareholders in the Saudi market; investors' interest in CG practices; and the role of CG in the

share selection process of investors. These five topics helped in producing and formulating the interview questions. Lichtman (2013) reports that interview questions must be created for the purpose of: (1) establishing an understanding of the interviewee knowledge; (2) discovering interviewees' viewpoints; (3) revealing their emotional responses; and (4) showing interviewees personal experiences. In addition, interview questions can be categorised into three categories: (1) opening questions; (2) middle questions that examine the issues in more details; and (3) concluding questions that can provide a summary of issues discussed as well as advice and recommendations (Bryman, 2004).

The last procedure applied in designing interview guide was reviewing the interview guide. Since there is no standardised form of interview guide (Gilbert, 2008), the researcher has created an interview guide (see Appendix B) and discussed it with supervisors and colleagues for comments. The interview guide, however, has been translated from English to Arabic, since the mother language of all potential interviewees is Arabic. The translation has been done by the researcher himself, and to ensure the accuracy and validity of the translation, an Arabic colleague in the school was kindly requested to translate it. Then, the two translations were compared and unified in one guide. See Appendix A for questions of the semi-structured interview.

5.3.2.3 *Sample Selection and Administration*

Corbin and Strauss (2008) states that collecting data by using theoretical sampling enables the researcher to determine themes and broad topics applicable to the main issue studied. Therefore, a non-probability sampling technique named the non-random sampling was seen fit to this research as it is common in qualitative research for interviewees selection process (Davidson, 2006, Saunders, Lewis and Thornhill, 2012).

According to Sekaran (2003) and Saunders, Lewis and Thornhill (2007), the quality of results depends on the quality of data, therefore, the selection process of major shareholders (interviewees) were carefully conducted. To begin with, interviewees were chosen based on their knowledge and experience in the topics concerning CG practices and major shareholdings in Saudi Arabia, which helps obtaining informed opinions and viewpoints (Bailey and Peck, 2013). Hence, the researcher focused primarily on the quality of data rather than the number of

participants as this standpoint helps in maintain the reliability of the data collected in this research, and such considerations assisted the researcher in meeting the research objectives.

It is worth noting that semi-structured interviews, which is a widely used method in studies concerning CG (Al-Saidi, 2012; Alshehri, 2012; Alghamdi, 2012), are accomplished by good relations to companies, officials, and managers. The researcher here has an experience of dealing with a large number of companies as he was the head of Cooperative Training department in College of Business Administration at Imam Abdulrahman bin Faisal University, and have good relationships with a lot of executives and managers of many companies, which eased the process of reaching interviewees. In addition, targeted interviewees were initially planned to be from all categories of major shareholders with emphasis on the most spread categories namely: Governmental institutions and family firms. Since the interviews are not the sole source of data for this research, a sample of 15 participants was selected based on the researcher relations to their entities and the easiness to reach them. However, other participants from other types of major shareholders became available to be interviewed too (see Table 5.4).

| # | CATEGORY | CODE | LOCATION | QUALIFICATIONS | COUNTRY OF STUDY | EXPEREINCE | INTERVIEW TYPE | DURATION |
|----|---------------------------|------|----------|----------------------------|------------------|------------|----------------|-------------|
| 1 | Family-owned Firms | R1 | Dammam | BA Business Administration | KSA | 23 YEARS | Face-to-face | 1hr 45 mins |
| 2 | | R2 | Dammam | BA Finance | USA | 9 YEARS | Face-to-face | 1hr 30 mins |
| 3 | | R3 | Riyadh | BA Business Administration | KSA | 8 YEARS | Face-to-face | 1hr 30 mins |
| 4 | Governmental Institutions | R4 | Riyadh | BA Business Administration | KSA | 16 YEARS | By Telephone | 45 mins |
| 5 | Insider or Affiliations | R5 | Riyadh | BA Accounting | KSA | 18 YEARS | Face-to-face | 1hr 30 mins |
| 6 | | R6 | Riyadh | Chartered Accountant | UK | 11 YEARS | Face-to-face | 1 hour |
| 7 | | R7 | Dammam | BA Accounting | USA | 7 YEARS | Face-to-face | 1hr 15 min |
| 8 | Wealthy Individuals | R8 | Dammam | PhD in Management | UK | 17 YEARS | Face-to-face | 1 hour |
| 9 | | R9 | Riyadh | BA Public Administration | KSA | 28 YEARS | By Telephone | 45 mins |
| 10 | Financial Firms | R10 | Riyadh | Executive MBA | UAE | 12 YEARS | Face-to-face | 1hr 45 mins |
| 11 | Fund and Insurance Firms | R11 | Dammam | BA Accounting & MBA | USA | 11 YEARS | Face-to-face | 1hr 15 min |
| 12 | Other Firms | R12 | Riyadh | Diploma in Management | KSA | 26 YEARS | Face-to-face | 1hr 10 mins |
| 13 | | R13 | Riyadh | MSc Accounting & Finance | UK | 9 YEARS | By Telephone | 50 mins |
| 14 | | R14 | Jeddah | BA Finance | KSA | 5 YEARS | By Telephone | 1 hour |
| 15 | | R15 | Jeddah | BA Business Administration | KSA | 15 YEARS | By Telephone | 1 hour |

Table 5.4: Interviewees Profile

As shown in Table 5.4, semi-structured interviews were conducted with fifteen participants from seven out of eight categories of major shareholders that are examined in this thesis namely: wealthy Families, government institutions, insiders, wealthy individuals, financial firms, fund and insurance firms, and other institutional investors. The academic qualifications of interviewees vary from BAs to PhDs in a number of business-related majors, except of one interviewee who gain only a Diploma in Management. These qualifications were gained from Saudi Arabia, US, UK and UAE. The range of years of experience among interviewees varied from five to twenty-eight years. Most of interviewees were in Riyadh and Dammam, however, two participants were located in Jeddah.

The researcher communicated with the proposed potential interviewees to check their availability using telephone and e-mail and delivered an offer letter stating: (1) the research objectives; (2) the interview objectives; (3) information about the researcher and the university; (4) the length of the interview; (5) the confidentiality policy followed by the researcher. Moreover, a list of the interview questions was provided too. It is believed that such procedures ensured the credibility of the researcher and encouraged interviewees to take a part of this research.

Subsequently, three trips have been made to Riyadh after arranging with interviewees. Unfortunately, few of them could not stick to the appointments made earlier due to their unavailability at the time, urgent business matters, or unwillingness to participate. This pushed the researcher to re-arrange other appointments or arrange interviews with new participants in the following trips. Due to the unavailability for face-to-face interviews, the rest of interviews with participants in Riyadh were conducted via telephone. Since the researcher's hometown is near Dammam, it was easier and less costly to arrange for face-to-face interviews with participants located within the same area. Finally, the two participants in Jeddah were interviewed via telephone.

The semi-structured interviews consisted of three main phases. The first phase was a mutual self-introduction between the researcher and the interviewee. The researcher began interviews with a friendly conversation with interviewees about their personal and business profile. During this phase, the researcher has also provided interviewees with a brief of: (i) the researcher profile; (ii) the research objectives and motivations; (iii) the interview objectives and process; and (iv) the confidentiality of the information disclosed during the interview. This phase is believed to be providing the interviewee with a broad idea of the type of data that the researcher

was pursuing. It is worth noting here that no interviewee had granted the researcher a permission to record the interview by any type of devices (mobile phones or tape-recorder). This seems a common phenomenon within developing markets (Alghamdi, 2012). As a result, notes were constantly taken during interviews. However, the flow of discussions throughout interviews, to some extent, limited the volume of notes that could be taken immediately. Therefore, the researcher ensured revising all notes after each interview in an attempt to clarify and/or add on some unwritten responses aiming at increasing the reliability of data collected.

In the second phase of interviews, several broad questions were prepared and asked to participants (see Appendix A) in order to provide the researcher with their views and experience concerning the CG system in Saudi Arabia and its effect on major shareholders decisions. The questions were split up into five themes: the perception of CG, the importance and compliance of CG, the perception of CG mechanisms, the role of major shareholders in the Saudi capital market, and finally the effect of CG on investment decisions of major shareholders (see Figure 5.2). During this phase, interviewees were granted the opportunity to freely express their own views regarding the issues discussed with no interruptions. According to Creswell and Clark (2011), this helps enriching the data collected. However, the researcher made attempts to bring the interview back on track if the discussion has gone far from the topics specified. Following the interview guide has assisted the researcher in covering all the prepared questions as well as writing the notes that helped managing the interview progress (Corbin and Strauss, 2008).

In the last phase of the semi-structured interviews, participants were given the opportunity to add any concluding remarks that may be seen worth mentioning. The researcher followed this by expressing his appreciation for the interviewees participation and time and reassured the confidentiality of the data collected. The last procedure that was followed in this phase was completing the note-taking to help enhancing the quality and accuracy of data gained, which took place after leaving the interview location.

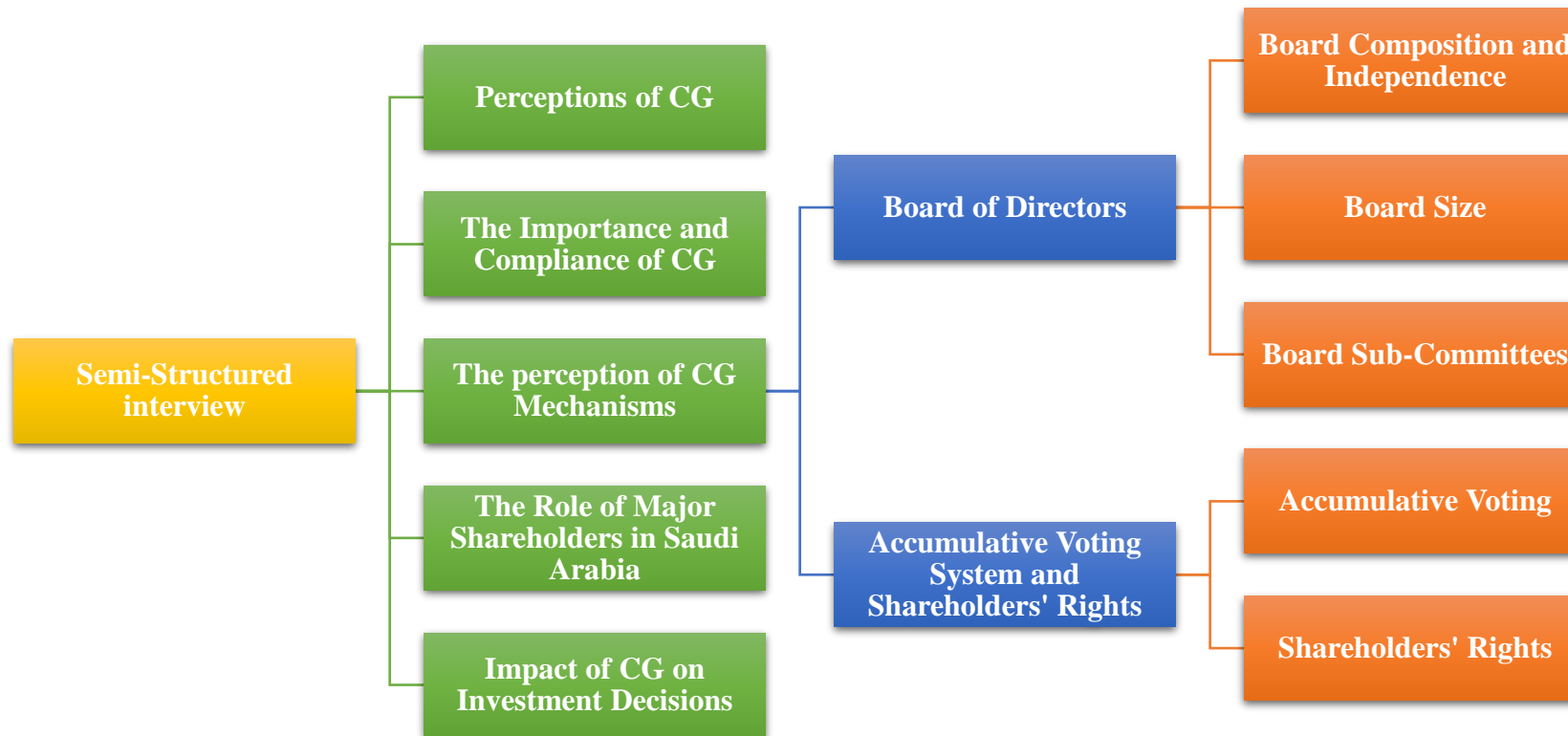


Figure 5.2: The Structure of Semi-Structured Interviews

5.4 Conclusion

This chapter presented the methodology employed in the analysis of this research. It discussed the theoretical background of research designs as well as the nature of research including the approach and design used. The chapter also focuses on the implemented procedures in the design of the research in relation to the collected primary and secondary data that assists in achieving the research objectives. Methods followed in the collection phase are presented in detail. The chapter has also demonstrated an outline of the statistical examinations utilised in the research as well as the design, sample and administration of the semi-structured interviewees conducted for collecting the primary data.

Chapter 6. Findings and Discussions of The Quantitative Assessment

6.1 Introduction

This chapter presents the findings of the quantitative assessment of this thesis that aims to statistically examine the perceived impact of CG on shares selection of major shareholders in the Saudi capital market. Additionally, it investigates the CG preferences of each category of major shareholders, which were demonstrated in Chapter Five.

This chapter is presented in five sections (i) descriptive statistics of variables used in the regression models; (ii) correlation matrix of all variables used; (iii) regression analysis and results; (iv) summary of main findings; and finally (v) robustness checks.

6.2 Descriptive Statistics

Table 6.1 presents the descriptive statistics for the dependant variable MAJORHOLD (total major shareholdings), categories of major shareholdings (MAJOR1-MAJOR8), the independent variables (CG variables), and control variables for each year within the tested period as well as the whole period (2013-2017). In Table 6.1, MAJORHOLD represents the percentage of shareholdings that is owned by major shareholders in each company included in the sample. For instance, in 2013, an average of 30% of total shareholdings of each sample company was owned by major shareholders. The Table shows that the mean major shareholdings in the 97 firms included in the sample have been increasing over time, which is consistent with the results of other studies conducted in the UK and the US such as Aggarwal et al. (2010), Chung and Zhang (2011), and Hawas and Tse (2016). To illustrate, the mean of major shareholdings in Saudi corporations have increased from 30.67% in 2013 to almost 37% in 2017. In addition, the average value for the major shareholdings for the entire period is 34%, which is also close to the mean in the UK and US markets (i.e., Aggarwal et al., 2010; Hawas and Tse, 2016).

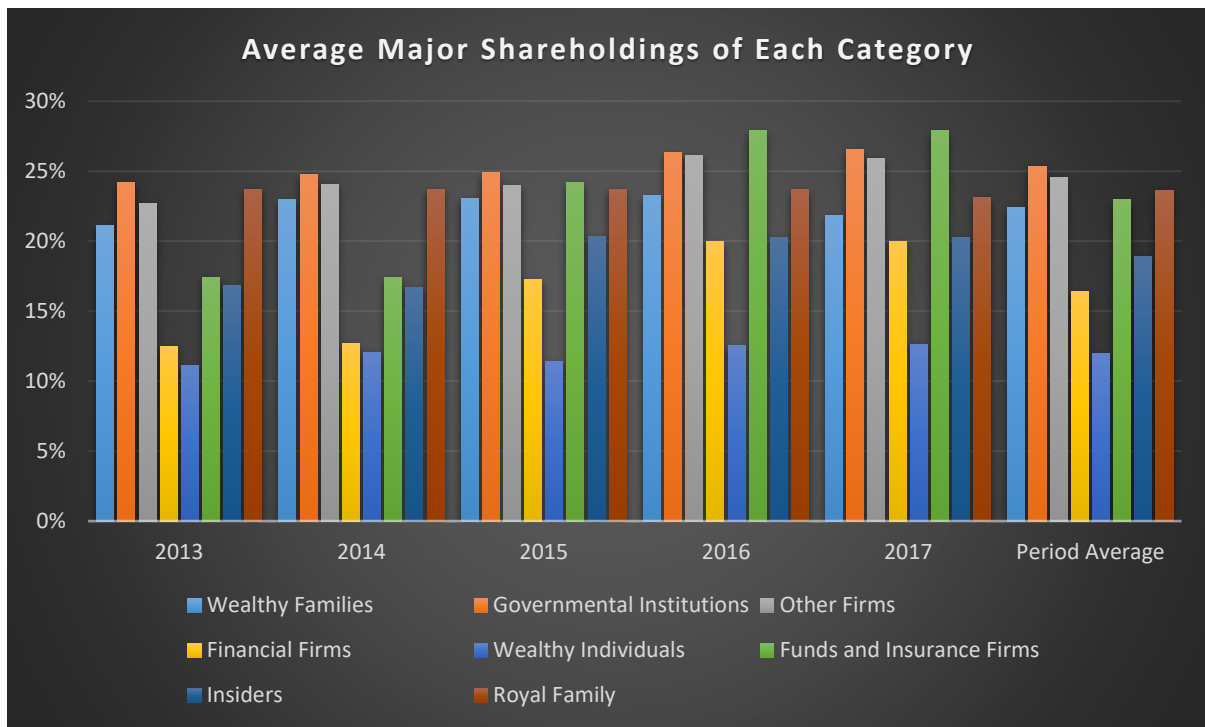


Figure 6.1: Mean major shareholdings over the study period

In addition, Table 6.1 and Figure 6.1 also present the average percentage of shares owned by each category of major shareholders as a percentage of total shares of their investee firms. For example, it can be noted that the average percentage of shares held by MAJOR2 in their investee firms have increased from 24.20% in 2013 to 26.52% in 2017 whereas the average percentage of shares held by MAJOR8 has decreased slightly from 23.73% in 2013 to 23.16% in 2017. Furthermore, by looking at the statistics in Table 6.1 and Figure 6.1, the highest average mean is gained by governmental institutions (MAJOR2), other firms (MAJOR3), royal investors (MAJOR8) and funds and insurance firms (MAJOR6), with averages of 25.33%, 24.57%, 23.61%, and 22.95% respectively. It is also found that the lowest average values belong to financial firms (MAJOR4) and wealthy individuals (MAJOR5) with an average of 16.46% and 11.94% respectively. In general, it can be noticed that major shareholdings of most categories have been increasing over the period tested except of MAJOR8, who hold steady amounts of shares over time with no significant increases or decreases.

| | Mean Median Std. Dev. (2013) | Mean Median Std. Dev. (2014) | Mean Median Std. Dev. (2015) | Mean Median Std. Dev. (2016) | Mean Median Std. Dev. (2017) | Mean Median Std. Dev. (Pooled) |
|-----------|-------------------------------------------------|-------------------------------------------------|-------------------------------------------------|-------------------------------------------------|-------------------------------------------------|---------------------------------------------------|
| MAJORHOLD | 30.67 25 | 32.082 28 | 34.258 30 | 37.093 33 | 36.804 32 | 34.181 30 |
| MAJOR 1 | 21.204 21.10 16.11 | 21.69 22.98 16.17 | 21.668 23.05 17.20 | 22.236 23.24 17.20 | 22.523 21.81 17.20 | 21.926 22.44 16.42 |
| MAJOR 2 | 18.07 24.20 14.8 | 20.05 24.74 14.92 | 19.64 24.88 15.72 | 19.66 26.31 15.72 | 18.75 26.52 16.32 | 18.98 25.33 15.72 |
| MAJOR 3 | 23.49 22.70 16.50 | 24.05 24.07 16.70 | 23.71 24.00 18.68 | 25.61 26.13 24.50 | 25.47 25.94 23.64 | 24.22 24.57 19.51 |
| MAJOR 4 | 16.98 12.48 8.23 | 17.76 12.67 8.83 | 17.31 17.25 10.88 | 17.25 19.94 19.96 | 17.37 19.97 19.96 | 17.13 16.46 11.25 |
| MAJOR 5 | 10.30 11.09 8.00 | 10.24 12.06 8.32 | 14.46 11.40 7.51 | 13.64 12.53 9.40 | 13.60 12.64 10.04 | 12.70 11.94 8.07 |
| MAJOR 6 | 7.51 17.41 17.28 | 8.63 17.43 17.31 | 8.37 24.16 24.75 | 7.85 27.88 30.00 | 7.84 27.88 30.00 | 7.89 22.95 23.50 |
| MAJOR 7 | 7.65 16.80 11.90 | 7.66 16.72 11.38 | 11.69 20.34 14.74 | 9.73 20.29 14.21 | 9.73 20.30 14.03 | 10.30 18.89 12.69 |
| MAJOR 8 | 11.94 23.73 14.80 | 11.72 23.73 14.80 | 13.36 23.71 14.89 | 13.42 23.71 14.89 | 13.46 23.16 14.89 | 12.40 23.61 14.89 |
| | 27.58 | 27.58 | 27.61 | 27.61 | 27.55 | 26.30 |
| CGSCORE | 82.309 88 | 84.289 88 | 73.732 75 | 74.784 75 | 97.856 100 | 82.594 88 |
| BODSIZE | 15.27 8.443 9 | 13.767 8.33 9 | 14.876 8.412 9 | 14.745 8.454 9 | 6.414 8.371 9 | 15.945 8.402 9 |
| BODINDP | 1.421 47.523 42.857 | 1.449 46.402 43 | 1.449 47.608 43 | 1.362 48.433 44 | 1.387 47 43 | 1.409 47.393 43 |
| BODNEDS | 14.3 40.94 42.857 | 13.564 42.577 44 | 14.855 42.216 44 | 14.202 41.474 44 | 13.146 44.351 44 | 13.984 42.312 44 |
| BODMEET | 15.87 5.392 5 | 16.128 5.495 5 | 17.59 5.237 5 | 17.334 5.196 5 | 15.962 5.361 5 | 16.566 5.336 5 |
| BODROYAL | 2.294 .165 0 | 2.204 .165 0 | 1.919 .165 0 | 1.777 .165 0 | 1.964 .155 0 | 2.035 .163 0 |
| | .373 | .373 | .373 | .373 | .363 | .37 |

| | Mean <i>Median</i> Std. Dev. (2013) | Mean <i>Median</i> Std. Dev. (2014) | Mean <i>Median</i> Std. Dev. (2015) | Mean <i>Median</i> Std. Dev. (2016) | Mean <i>Median</i> Std. Dev. (2017) | Mean <i>Median</i> Std. Dev. (Pooled) |
|---------|----------------------------------------------|----------------------------------------------|----------------------------------------------|----------------------------------------------|----------------------------------------------|------------------------------------------------|
| FSIZE | 9394.955 <i>1767.09</i> 30439.968 | 12444.436 <i>2216.25</i> 38481.362 | 12023.975 <i>2505.6</i> 33200.807 | 8801.845 <i>1437.5</i> 27968.705 | 10042.048 <i>1499.5</i> 33368.974 | 10541.452 <i>1878.57</i> 32775.586 |
| FLEV | .181 <i>.158</i> .188 | .193 <i>.164</i> .19 | .201 <i>.191</i> .2 | .201 <i>.146</i> .204 | .2 <i>.14</i> .206 | .195 <i>.16</i> .197 |
| FTURN | 4.706 <i>1.47</i> 5.421 | 3.53 <i>2.28</i> 3.48 | 4.535 <i>2.2</i> 4.503 | 3.272 <i>1.94</i> 3.679 | 4.267 <i>1.8</i> 6.129 | 4.062 <i>2</i> 4.765 |
| FDY | 2.821 <i>2.92</i> 2.684 | 2.177 <i>2.03</i> 2.164 | 2.225 <i>1.77</i> 2.226 | 3.342 <i>3.09</i> 3.323 | 3.057 <i>2.87</i> 2.983 | 2.724 <i>2.39</i> 2.74 |
| FROA | .032 <i>.042</i> .156 | .068 <i>.049</i> .102 | .061 <i>.056</i> .092 | .062 <i>.049</i> .107 | .054 <i>.038</i> .084 | .055 <i>.045</i> .111 |
| FTOBIN | .477 <i>.49</i> .244 | .488 <i>.51</i> .239 | .49 <i>.53</i> .227 | .484 <i>.54</i> .224 | .486 <i>.53</i> .224 | .485 <i>.51</i> .231 |
| FRETURN | .179 <i>.18</i> .277 | .003 <i>-.08</i> .354 | -.181 <i>-.22</i> .218 | -.016 <i>-.07</i> .286 | -.032 <i>-.06</i> .24 | -.009 <i>-.06</i> .3 |
| FPRICE | 41.285 <i>31.38</i> 27.2 | 42.69 <i>31.7</i> 44.68 | 33.916 <i>26.3</i> 27.885 | 30.997 <i>22.85</i> 22.496 | 29.199 <i>20.1</i> 22.747 | 35.617 <i>27</i> 30.488 |
| FAGE | 22.845 <i>23</i> 15.864 | 23.845 <i>24</i> 15.864 | 24.845 <i>25</i> 15.864 | 25.856 <i>26</i> 15.871 | 26.856 <i>27</i> 15.871 | 24.849 <i>24</i> 15.865 |

Table 6.1: Pooled and Yearly Descriptive Statistics for the Dependant, Independent, and Control Variables

MAJORHOLD is the percentage of shares owned by major shareholders in each company included in the sample; **MAJOR 1** is major shareholdings owned by wealthy families as a percentage of the total shareholdings of their investee companies; **MAJOR 2** is major shareholdings owned by governmental institutions as a percentage of the total shareholdings of their investee companies; **MAJOR 3** is major shareholdings owned by institutional investors not included in other categories as a percentage of the total shareholdings of their investee companies; **MAJOR 4** is major shareholdings owned by financial firms as a percentage of the total shareholdings of their investee companies; **MAJOR 5** is major shareholdings owned by wealthy individuals as a percentage of the total shareholdings of their investee companies; **MAJOR 6** is major shareholdings owned by funds and insurance firms as a percentage of the total shareholdings of their investee companies; **MAJOR 7** is major shareholdings owned by insiders as a percentage of the total shareholdings of their investee companies; **MAJOR 8** is major shareholdings owned by members of the royal family as a percentage of the total shareholdings of their investee companies; **CGSCORE** is the total score of the CG score; **BODSIZE** is the number of board members; **BODINDP** is the number of board independent members; **BODNEDS** is the number of board NEDs; **BODMEET** is the number of annual board meetings; **BODROYAL** is 1 (if a royal member exists in the boards), 0 otherwise; **FSIZE** is the firm's market value; **FLEV** is the percentage of total debt to total assets; **FTURN** is the annual share volume over the year to share outstanding; **FDY** is the dividends per share to market price-year end; **FROA** is the percentage of net income to total assets; **FTOBIN** is the market value of equity plus total debts to total assets; **FRETURN** is the annual (end-of-year) geometric stock rate of return; **FPRICE** is the firm's year-end share price; **FAGE** is the firm's establishment age.

Figure 6.2 presents the distribution of major shareholdings among the different categories of major shareholders. It is seen that the most three categories that dominantly hold major shareholdings within the Saudi capital market are: governmental institutions, other institutional investors, and wealthy families with mean percentages of 25.33%, 24.53% and 22.4% respectively. See Appendix E for more descriptive statistics of different types of major shareholders.

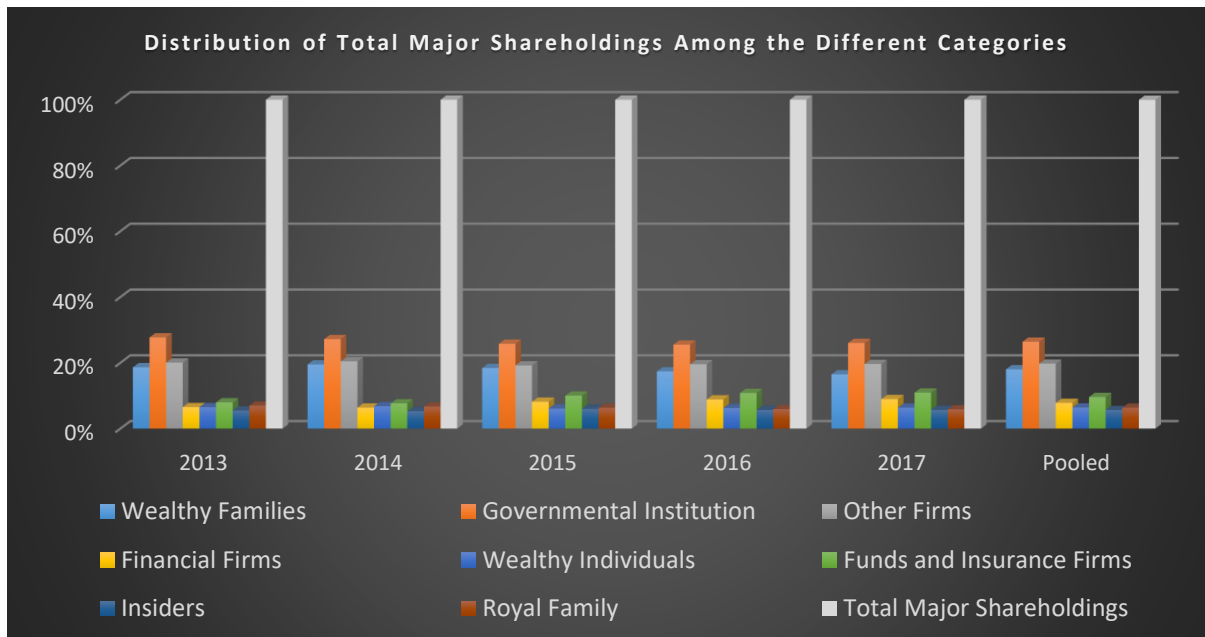


Figure 6.2: Distribution of Total Major Shareholdings Among the Different Categories

Moreover, several interesting outcomes are generated by such statistics presented in Table 6.1 and Table 6.2. The statistics shown in Table 6.1 indicate that the mean CGSCORE has increased from 0.82 in 2013 to almost 0.98 in 2017. However, this value encountered drops in 2015 and 2016 but in general this result indicates that there has been a noticeable improvement in the Saudi CG and the compliance rate is showing an increase in the level of awareness of CG importance among Saudi firms. Turning to board characteristics, boards in the Saudi market consist of 8 members on average (mean = 8.4), which is slightly lower than the number reported in the UK and US by Bhagat and Black (2002) and Habbash (2010) respectively. Table 6.2 shows that the maximum (minimum) number of board member is 11 (5) which indicates that listed companies in fact comply with the CG law that requires boards to be consisted of 3 to 12 members.

The results in Table 6.2 also show that almost 90% of board members are independent or/and NEDs, which reflects a notable high compliance rate by the Saudi listed firms with CG regulations that require boards to be dominantly consist of non-executive members. Saudi corporate boards meet on average five times a year (mean = 5.34), while some boards have met up to seventeenth times a year. This mean value is a bit lower than the average number of board meetings in the US as reported by Uzun et al. (2004). Furthermore, the average natural logarithm of market value of listed firms in the Saudi capital market for the whole period is SAR 10541.45. This is relatively high due to the existence of huge firms such as SABIC that has a market value of SAR 343499.9.

| | N | Std. Dev. | Mean | Median | Min | Max | Kurtosis | Skewness |
|-------------|----------|------------------|-------------|---------------|------------|------------|-----------------|-----------------|
| MAJORHOLD | 485 | 21.93 | 34.18 | 30 | 5 | 98 | 2.88 | .76 |
| CGSCORE | 485 | 15.95 | 82.59 | 88 | 38 | 100 | 2.2 | -.53 |
| BODSIZE | 485 | 1.41 | 8.4 | 9 | 5 | 11 | 2.6 | -.09 |
| BODINDP | 485 | 13.98 | 47.39 | 43 | 17 | 86 | 2.49 | .65 |
| BODNEDS | 485 | 16.57 | 42.31 | 44 | 0 | 83 | 2.19 | -.27 |
| BODMEET | 485 | 2.03 | 5.34 | 5 | 1 | 17 | 9.4 | 1.9 |
| BODROYAL | 485 | .37 | .16 | 0 | 0 | 1 | 4.33 | 1.83 |
| FSIZE | 485 | 32775.59 | 10541.45 | 1878.57 | 206.8 | 343499.9 | 57.61 | 6.9 |
| FSIZE (LOG) | 485 | 0.63 | 3.43 | 3.27 | 2.32 | 5.54 | 3.22 | 0.81 |
| FLEV | 485 | .2 | .19 | .16 | 0 | .74 | 2.15 | .61 |
| FTURN | 485 | 4.77 | 4.06 | 2 | .03 | 45.18 | 14.87 | 2.41 |
| FDY | 485 | 2.74 | 2.72 | 2.39 | 0 | 12.36 | 2.51 | .65 |
| FROA | 485 | .11 | .06 | .04 | -.79 | .34 | 12.55 | -1.43 |
| FTOBIN | 485 | .23 | .48 | .51 | .01 | .91 | 2.07 | -.25 |
| FRETURN | 485 | .3 | -.01 | -.06 | -.68 | 1.35 | 4.62 | .94 |
| FPRICE | 485 | 30.49 | 35.62 | 27 | 6.8 | 403.5 | 47.74 | 4.74 |
| FAGE | 485 | 15.86 | 24.85 | 24 | 3 | 64 | 2.24 | .43 |

Table 6.2: Descriptive Statistics for the dependant, independent, and control variables

MAJORHOLD is the percentage of shares owned by shareholders with at least 5% of the company shares; **CGSCORE** is the total score of the CG score; **BODSIZE** is the number of board members; **BODINDP** is the percentage of board independent members; **BODNEDS** is the percentage of board NEDs; **BODMEET** is the number of annual board meetings; **BODROYAL** is 1 (if a royal member exists in the boards), 0 otherwise; **FSIZE** is the firm's market value; **FLEV** is the percentage of total debt to total assets; **FTURN** is the annual share volume over the year to share outstanding; **FDY** is the dividends per share to market price-year end; **FROA** is the percentage of net income to total assets; **FTOBIN** is the market value of equity plus total debts to total assets; **FRETURN** is the annual (end-of-year) geometric stock rate of return; **FPRICE** is the firm's year-end share price; **FAGE** is the firm's establishment age.

The average ROA is 6%, with a maximum of 34% and a minimum of -79.18%, while the average Leverage is 20%, with a maximum of 74.43% and a minimum of 0%. Additionally, the mean (median) value of Turnover, Dividend Yield, Stock Return, Stock Price and Age are 4.06 (2), 2.72 (2.39), -0.01 (-0.06), 35.62 (27) and 24.85 (24) respectively. Moreover, the mean (median) value of Tobin's Q was 0.48 (0.51) which indicates that Saudi listed companies were in fact undervalued as their assets cost more than the value of their stocks.

6.3 Correlation Matrix

This section presents the correlations between all dependant, independent and control variables used in this research by generating Pearson's correlation matrix to check for any multicollinearity cases that may occur (see Table 6.3). Correlations that exceed 0.8 reflect a multicollinearity problem which eventually could impact the outcome of the research (Belsley et al., 1980; Gujarati, 1995; Haniffa and Cooke, 2005). In general, the correlation coefficients shown in Table 6.3 indicate that, statistically, the correlations between the variables are fairly low, which suggests that multicollinearity problem is not found. However, few coefficients (e.g., between BODINDP and BODNEDS) were close to the threshold of 0.8 but still seen as harmless collinearity. As an additional tool for detecting multicollinearity, this research uses the Variance Inflation Factors (VIF) test for all variables used in the research models. The VIF value is acceptable as long as it does not go beyond 10 (Gujarati, 2003; Abdul Rahman and Ali, 2006). The results of this test showed that the mean VIF for all models used in the tests are within acceptable limits, which supports the results of Pearson's correlation matrix that multicollinearity is not an issue that may affect the validity of this research results.

| Variables | (1) | (2) | (3) | (4) | (5) | (6) | (7) | (8) | (9) | (10) | (11) | (12) | (13) | (14) | (15) | (16) |
|---------------|--------|-------|--------|--------|--------|-------|--------|--------|--------|--------|--------|--------|--------|-------|-------|------|
| (1) MAJORHOLD | 1.00 | | | | | | | | | | | | | | | |
| (2) CGSCORE | -0.04 | 1.00 | | | | | | | | | | | | | | |
| (3) BODSIZE | 0.03 | -0.00 | 1.00 | | | | | | | | | | | | | |
| (4) BODINDP | -0.362 | -0.01 | -0.10 | 1.00 | | | | | | | | | | | | |
| (5) BODNEDS | 0.247 | 0.05 | 0.204 | -0.780 | 1.00 | | | | | | | | | | | |
| (6) BODMEET | 0.13 | 0.04 | -0.05 | 0.04 | -0.06 | 1.00 | | | | | | | | | | |
| (7) BODROYAL | 0.08 | 0.05 | 0.04 | -0.07 | 0.04 | -0.07 | 1.00 | | | | | | | | | |
| (8) FSIZE | 0.447 | 0.09 | 0.14 | -0.209 | 0.166 | 0.12 | 0.186 | 1.00 | | | | | | | | |
| (9) FLEV | 0.12 | -0.10 | 0.10 | -0.13 | 0.05 | -0.03 | -0.08 | 0.11 | 1.00 | | | | | | | |
| (10) FTURN | -0.299 | 0.04 | -0.237 | 0.183 | -0.08 | -0.05 | -0.03 | -0.221 | -0.333 | 1.00 | | | | | | |
| (11) FDY | -0.04 | -0.01 | 0.203 | 0.14 | -0.187 | 0.03 | 0.12 | 0.13 | 0.11 | -0.484 | 1.00 | | | | | |
| (12) FROA | 0.11 | 0.00 | 0.03 | -0.174 | 0.09 | -0.06 | 0.07 | 0.04 | -0.213 | -0.281 | 0.232 | 1.00 | | | | |
| (13) FTOBIN | 0.04 | 0.00 | -0.02 | -0.153 | 0.225 | -0.03 | -0.241 | -0.01 | 0.350 | 0.259 | -0.392 | -0.277 | 1.00 | | | |
| (14) FRETURN | 0.08 | 0.05 | -0.00 | -0.10 | 0.05 | -0.01 | -0.09 | 0.04 | 0.01 | -0.163 | 0.01 | 0.227 | -0.02 | 1.00 | | |
| (15) FPRICE | 0.12 | -0.03 | 0.02 | -0.06 | -0.06 | 0.00 | 0.03 | 0.250 | -0.11 | -0.203 | 0.15 | 0.229 | -0.156 | 0.289 | 1.00 | |
| (16) FAGE | -0.07 | -0.11 | -0.07 | 0.06 | -0.275 | 0.194 | 0.10 | 0.03 | 0.11 | -0.316 | 0.509 | 0.13 | -0.426 | -0.02 | 0.257 | 1.00 |

*** $p < 0.01$, ** $p < 0.05$

Table 6.3: Pearson's Correlation Matrix

This table presents Pearson's correlation matrix for the main variables used in our analysis. **MAJORHOLD** is the percentage of shares owned by shareholders with at least 5% of the company shares; **CGSCORE** is the total score of the CG score; **BODSIZE** is the number of board members; **BODINDP** is the number of board independent members; **BODNEDS** is the number of board NEDs; **BODMEET** is the number of annual board meetings; **BODROYAL** is 1 (if a royal member exists in the boards), 0 otherwise; **FSIZE** is the firm's market value; **FLEV** is the percentage of total debt to total assets; **FTURN** is the annual share volume over the year to share outstanding; **FDY** is the dividends per share to market price-year end; **FROA** is the percentage of net income to total assets; **FTOBIN** is the market value of equity plus total debts to total assets; **FRETURN** is the annual (end-of-year) geometric stock rate of return; **FPRICE** is the firm's year-end share price; **FAGE** is the firm's establishment age.

6.4 Regression Analysis Results

6.4.1 Pooled Regression Results

As explained in Chapter Five (Table 5.3, Panel A), this research uses two main regression models to examine the impact of CG on aggregate major shareholdings in the Saudi capital market (i) Pooled OLS Regression model consisting of all categories of major shareholders and (ii) Pooled OLS Regression model of all categories of major shareholders except of MAJOR1 (non-family sample). The researcher performed the pooled OLS regression as an initial test. Additionally, the Hausman test has been performed that determines which panel data method is more appropriate for the data used namely: fixed-effects and random-effects models. The results showed that fixed-effect model is appropriate, therefore, the model has been performed subsequently to ensure the non-existence of endogeneity issues and control for heterogeneity (explained in Section 6.6). The reason for constructing the following discussion on the results of pooled OLS regression is that CG variables tend to be time invariant so that their impact cannot be investigated using fixed effects model (Bai et al., 2004; p.610), which would weaken the regression results. Nevertheless, the results of the fixed effects module are qualitatively similar to the results of pooled OLS regression.

In Table 6.2, the figures of the skewness and kurtosis of some continuous variables, namely, BODMEET, FSIZE, FTURN, FROA and FPRICE, are suffering from the problem of outliers. The variance of their maximum and minimum values is also large. Salama (2005) states that one of the common problematic characteristics in financial data is the presence of outliers. It argues that OLS procedures are strongly affected by the problem of outliers even in the presence of only one strongly extreme value, which can affect the model, the significance tests, and the prediction intervals. However, McWilliams and Siegel (1997) claims that excluding such values from the selected sample in the excuse of being troublesome can actually create further problems. It states that the presence of outliers may flag important points related to the presence of confounding effects. Additionally, Salama (2005) claims that such outliers can be transformed or deleted but this step is not supposed to be deemed as a solution for this problem. Instead, it suggests using robust standard errors (commonly known as white corrected standard error) to help moderate the problem of outliers. Therefore, this research employs the robust standard error in the regression models to ease such problem and to correct the linearity of some variables.

Table 6.4 presents the pooled regression results with robust standard error for the two models shown in Table 5.3 Panel A (Model 1 and Model 2). The main and first regression model is a pooled regression that includes major shareholdings as a dependant variable CG score and board characteristics as independent variables in addition to firm characteristics as control variables. Interestingly, the results of the first regression indicate that CGSCORE has a significant negative relationship to major shareholdings with R^2 value of (0.353). This means that major shareholders in the Saudi capital market do not favour CG mechanisms included in this score, which are mainly related to voting rights and general assembly regulations. As a result, major shareholders actually prefer companies with less compliance with our CG score mechanisms. However, this also may indicate that CG is in fact taken into consideration when major shareholders make their investment decisions, which is supported by the significance level of the relationship.

In addition, the negative significant relationship between major shareholdings and CG can be interpreted on a theoretical level. The principal-agent conflict (discussed earlier) is deemed as the traditional view of agency theory since the majority of CG research has been examining developed markets. On the other hand, the principal-principal conflict arises in markets with concentrated ownership (Alakkas, 2016), which basically occurs when there are different preferences between major shareholders and small shareholders. According to (Coffee, 2005), major shareholders play a corresponding role in concentrated markets. This view of the agency relationship concentrates on another dimension that involves the relationship between major shareholders/principals and minor shareholders/principals, where major shareholders have relationships with both minor shareholders and management (Young et al., 2008). As mentioned earlier, the Saudi CG model Arabia leans towards the Anglo-Saxon model whereas the market is characterised with concentrated ownership structure. As a result, this situation may form serious agency problems because of conflicts between both principals (Major and Minor shareholders). The principal-principal conflicts are considered more influential compared to the traditional principal-agent conflict (Gorton and Schmid, 2000; Lehmann and Weigand, 2000; Andres, 2008; Dittmann, Maug and Schneider, 2010; Engelen, 2015). This situation may lead to the expropriation of minor shareholders rights (Baydoun et al., 2013) as well as Given this, this negative and significant relationship generated by the regression analysis seems to indicate that major shareholders believe their controlling power is becoming limited due the imposing of shareholders' rights that are included in the CGSCORE. Additionally, the

information asymmetry that major shareholders had been exploiting over the year seem to be diminishing under the Saudi CGC 2006, which seems to be unfavourable to such investors.

On the other aspect of CG variables, the regressions results show that major shareholders do not prefer large boards that consist of independent and/or non-executive directors. Nevertheless, the coefficient of board meetings is statistically significant and positively related to total major shareholdings. This is partially supported with previous studies that illustrated the importance of CG mechanisms to investors (Ferreira and Matosm, 2008; Giannetti and Simonov, 2006; Khurshed et al., 2011).

Consistent with other studies, the regression results find that investors tilt their portfolio toward large firms similar to the results reported in Gompers and Metrick (2001). In addition, major investors in the Saudi capital market, unlike others in previous studies (i.e. Falkenstein, 1996 and Huang, 2009), have a significant and negative relationship with leverage and companies with high liquidity. Nevertheless, they avoid companies with high cash dividend which is line with the findings of prior studies such as Grinstein and Michaely (2005). The regression results show that total major shareholders have no significant relationship the existence of royal members in board, ROA, Tobins' Q, stock return and stock price.

| Variables | (Model 1) | (Model 2) |
|-----------------|--------------------|--------------------|
| <i>CGSCORE</i> | -.143** (.061) | .004 (.074) |
| <i>BODSIZE</i> | -.018*** (.005) | -.014** (.006) |
| <i>BODINDP</i> | -.444*** (.087) | -.305*** (.102) |
| <i>BODNEDS</i> | -.149** (.075) | -.119 (.092) |
| <i>BODMEET</i> | .011*** (.004) | .011** (.005) |
| <i>BODROYAL</i> | .021 (.017) | .024 (.018) |
| <i>FSIZE</i> | .111*** (.019) | .14*** (.02) |
| <i>FLEV</i> | -.107** (.049) | -.172*** (.056) |
| <i>FTURN</i> | -.008*** (.002) | -.008*** (.003) |
| <i>FDY</i> | -.009** (.004) | -.016*** (.004) |
| <i>FROA</i> | .025 (.068) | .111 (.07) |
| <i>FTOBIN</i> | .055 (.04) | .109*** (.041) |
| <i>FRETURN</i> | .011 (.027) | .016 (.03) |
| <i>FPRICE</i> | 0 (0) | 0 (0) |
| <i>FAGE</i> | -.002*** (.001) | -.002 (.001) |
| _cons | .712*** (.121) | .355** (.141) |
| Observations | 485 | 350 |
| R-squared | .353 | .431 |
| VIF | 1.95 | 1.99 |

Robust standard errors are in parentheses

*** $p < .01$, ** $p < .05$

Table 6.4: Regression Results of Corporate Governance (CG) Variables and Major Shareholdings

CGSCORE is the total score of the CG score; **BODSIZE** is the number of board members; **BODINDP** is the number of board independent members; **BODNEDS** is the number of board NEDs; **BODMEET** is the number of annual board meetings; **BODROYAL** is 1 (if a royal member exists in the boards), 0 otherwise; **FSIZE** is the firm's market value; **FLEV** is the percentage of total debt to total assets; **FTURN** is the annual share volume over the year to share outstanding; **FDY** is the dividends per share to market price-year end; **FROA** is the percentage of net income to total assets; **FTOBIN** is the market value of equity plus total debts to total assets; **FRETURN** is the annual (end-of-year) geometric stock rate of return; **FPRICE** is the firm's year-end share price; **FAGE** is the firm's establishment age.

Furthermore, Chapter Five has discussed the issue of major shareholdings of wealthy families and their role within the Saudi capital market. Based on such argument, this research re-estimated the regression model by performing an additional model that excludes major shareholdings of wealthy families (see Table 6.4 Model 2). Interesting results have been generated from this additional regression model. The results indicate that the CG score coefficient is positively related to major shareholdings with R^2 value of 0.431. However, the coefficient is not statistically significant, but the relationship is not negative as it was under Model 1. In addition, this regression model shows that board meetings variable remains significantly and positively related to major shareholdings. This suggests that block holders consider these mechanisms when making share selections of their investment portfolios. The positive linkage between major shareholdings and some of the board characteristics provide empirical support for the results of Chung and Zhang (2011) and Khurshed et al. (2011).

On the other hand, major shareholdings remain to have a significantly negative relationship with board size and independence. This group of major shareholders still tilt their portfolios toward investee firms with smaller boards and less independent member among them. The reason for disliking independent members in boards could be the result of the market being in the early processes of developing and has conservative characteristics which lead major investors to dislike outsiders in their investee firms. Major investors in the Saudi capital do not seem to vision independent board members as a complementary control mechanism, and this is probably why there is usually a representative of such major investors in boards.

In regard of control variables, the regression results of this model indicate that major shareholders prefer large firms with higher Tobin's Q value, which is similar to the results in the UK and US too (i.e. Gompers and Metrick, 2001; Hawas and Tse, 2016; Khurshed et al., 2011). Major shareholders also seem to lean toward firms with higher price and ROA with taking into consideration that the relation is economically insignificant. The relationship between major shareholdings and debt is also significantly negative in this model. However, the association of major shareholdings to FRETURN, FPRICE and FAGE are weak and cannot be generalised. Moreover, unlike the results of several US studies (e.g., Badrinath, Gerald and Jayant, 1989; Lakonishok, Shleifer and Vishny, 1994; Del Guercio, 1996; Falkenstein, 1996), the regression results of both models indicate a negative relationship between major shareholdings and liquidity (Share Turnover) with statistical significance, which is consistent with Khurshed et al. (2011) that found UK institutional block-holders prefer companies with lower liquidity. The reason for such relationship can be resulted by the fact that many major

shareholdings exist in insurance companies and pension funds, which are not being traded in the capital market as frequently as other types of companies. This is supported by the findings of O'Barr and Conley (1992) and Black (1992) as cited in Khurshed et al. (2011, p. 22), which stated that trading behaviour of insurance companies and funds is different from other companies because of their relatively long-run horizon of their clients.

Finally, the results show that FDY is significantly and negatively linked to major shareholdings in both Model 1 and 2. The underlying justification for this significant negative relationship can be the fact that major shareholders in the Saudi capital market prefer their investee firms to cut dividend pay and reinvest such amounts in expansion opportunities, which would give shareholders profits in the form of capital gains.

6.4.2 Preferences of Different Types of Major Shareholders

As shown in Table 5.3 Panel B in Chapter Five, the main regression model is re-estimated by separately replacing categories of major shareholders as dependent variables to examine whether they have different preferences of CG. The results of these eight models are provided in Table 6.5. It is necessary to indicate that Models 1-8 refer to wealthy families (MAJOR1), governmental institutions (MAJOR2), other institutional investors (MAJOR3), financial firms (MAJOR4), wealthy individuals (MAJOR5), funds and insurance firms (MAJOR6), managerial/insiders holdings (MAJOR7), and royal family (MAJOR8), respectively.

The coefficient of CGSCORE is only positively linked to three types of major shareholders namely: other institutional investors (MAJOR3, Model 3), wealthy individuals (MAJOR5, Model 5) and Royal Family (MAJOR8, Model 8) with R^2 of 0.354, 0.595 and 0.0972 respectively. The relationship is statistically insignificant with MAJOR3 and MAJOR8 but statistically significant with MAJOR5. These findings provide an evidence that the three categories consider CG practices of potential investee firms during the decision-making process of their portfolio's options, particularly MAJOR5 (wealthy individuals), who seem to be counting on higher CG quality of investee firms to protect their interests. The finding of the positive relationship between MAJOR3 and CG is supported by the previous studies of Bushee et al. (2010), Chung and Zhang (2011), Hawas and Tse (2016), Khurshed et al. (2011) and Russell Reynolds Associates survey (2003, 2005).

Consistent with the work of Al-Assaf et al. (2017), the results of MAJOR1 regression test indicate that major shareholdings of wealthy families statistically do not seem to pay attention to the goodness of CG practices of investee companies (see Model 1 in Table 6.5). In fact, their major holdings have a significant and negative association with the research CG score, board size, board independence, board NEDs and board royal members. Additionally, they are negatively associated with board meetings too but with no statistical significance. This is explained by Aleshaikh (2018) which showed that families control the types of members nominated in boards with the priority to their interests. Additionally, these results are also supported by Al-Assaf et al. (2017) which found that independent board members are the least favourable board component to families as investors. They claim that only family members are appointed as NEDs on boards of investee firms. On the other hand, the results show that wealthy families prefer to invest in large firms with smaller boards, which provides an evidence that supports the results of prior studies such as Gompers and Metrick (2001).

| Variables | Model 5 MAJOR 1 | Model 6 MAJOR 2 | Model 7 MAJOR 3 | Model 8 MAJOR 4 | Model 9 MAJOR 5 | Model 10 MAJOR 6 | Model 11 MAJOR 7 | Model 12 MAJOR 8 |
|-----------------|--------------------|--------------------|--------------------|--------------------|--------------------|---------------------|---------------------|---------------------|
| <i>CGSCORE</i> | -.567*** (.09) | -.215 (.126) | .043 (.124) | -.02 (.011) | .462*** (.104) | -.024 (.057) | -.238 (.125) | .173 (.131) |
| <i>BODSIZE</i> | -.06*** (.012) | -.054*** (.011) | -.04*** (.012) | -.006*** (.002) | -.026 (.018) | -.019** (.009) | -.001 (.018) | -.07*** (.017) |
| <i>BODINDP</i> | -.58*** (.147) | -.225 (.269) | -.296 (.245) | -.009 (.024) | -.042 (.186) | -.242 (.136) | .512** (.218) | -.365 (.238) |
| <i>BODNEDS</i> | -.418*** (.114) | -.094 (.239) | -.073 (.259) | .004 (.023) | .054 (.186) | -.352*** (.128) | .435 (.22) | -.325** (.144) |
| <i>BODMEET</i> | -.009 (.005) | .03*** (.007) | .006 (.011) | .003** (.002) | .005 (.008) | -.008 (.004) | -.011 (.011) | .005 (.012) |
| <i>BODROYAL</i> | -.19*** (.051) | .042 (.058) | .024 (.043) | -.016** (.008) | -.056** (.028) | -.054 (.034) | .09 (.06) | -.273*** (.084) |
| <i>FSIZE</i> | .125*** (.045) | .176*** (.048) | .04 (.05) | .002 (.004) | 0.000 (0.000) | .243*** (.038) | -.052 (.067) | .16*** (.041) |
| <i>FLEV</i> | -.085 (.086) | -.1 (.138) | .056 (.152) | .015 (.016) | .69*** (.144) | -1.6*** (.425) | .089 (.278) | .22 (.25) |
| <i>FTURN</i> | -.01** (.004) | .031*** (.01) | -.017** (.006) | .001 (0) | .002 (.004) | -.002** (.001) | .015** (.006) | -.011** (.005) |
| <i>FDY</i> | .001 (.005) | -.01 (.008) | -.016 (.008) | -.001 (.001) | -.012 (.007) | -.016*** (.004) | -.01 (.008) | .001 (.005) |
| <i>FROA</i> | -.233** (.102) | .23 (.232) | -.084 (.14) | .009 (.014) | .377** (.146) | .044 (.05) | -.521 (.452) | -.436 (.238) |
| <i>FTOBIN</i> | -.026 (.075) | .115 (.11) | -.137 (.106) | .002 (.01) | -.444*** (.123) | -.275*** (.065) | -.26 (.205) | -.246 (.224) |
| <i>FRETURN</i> | .044 (.051) | -.141** (.062) | -.05 (.049) | -.008** (.004) | -.033 (.059) | .058*** (.019) | .067 (.084) | .06 (.064) |
| <i>FPRICE</i> | -.001** (.001) | .001 (.001) | .001 (.001) | 0.000** (0.000) | .001*** (0.000) | -.002*** (.001) | 0.000 (.001) | .002 (.001) |
| <i>FAGE</i> | 0.000 (.001) | 0.000 (.001) | -.002 (.002) | 0.000 (0.000) | .003** (.001) | .002 (.008) | -.004*** (.001) | -.007*** (.002) |
| _cons | 1.587*** (.17) | .322 (.379) | .896*** (.332) | .195*** (.037) | .001 (.208) | .29 (.278) | .342 (.206) | .904*** (.268) |
| Observations | 135 | 175 | 135 | 80 | 90 | 70 | 50 | 45 |
| R-squared | .718 | .396 | .354 | .543 | .595 | .823 | .737 | .972 |

Robust standard errors are in parentheses

*** $p < .01$, ** $p < .05$

Table 6.5: Regression Results of Corporate Governance (CG) Variables and Categories of Major Shareholders

MAJOR 1 is major shareholdings owned by wealthy families as a percentage of the total shareholdings of their investee companies; **MAJOR 2** is major shareholdings owned by governmental institutions as a percentage of the total shareholdings of their investee companies; **MAJOR 3** is major shareholdings owned by institutional investors not included in other categories as a percentage of the total shareholdings of their investee companies; **MAJOR 4** is major shareholdings owned by financial firms as a percentage of the total shareholdings of their investee companies; **MAJOR 5** is major shareholdings owned by wealthy individuals as a percentage of the total shareholdings of their investee companies; **MAJOR 6** is major shareholdings owned by funds and insurance firms as a percentage of the total shareholdings of their investee companies; **MAJOR 7** is major shareholdings owned by insiders as a percentage of the total shareholdings of their investee companies; **MAJOR 8** is major shareholdings owned by members of the royal family as a percentage of the total shareholdings of their investee companies; **CGSCORE** is the total score of the CG score; **BODSIZE** is the number of board members; **BODINDP** is the number of board independent members; **BODNEDS** is the number of board NEDs; **BODMEET** is the number of annual board meetings; **BODROYAL** is 1 (if a royal member exists in the boards), 0 otherwise; **FSIZE** is the firm's market value; **FLEV** is the percentage of total debt to total assets; **FTURN** is the annual share volume over the year to share outstanding; **FDY** is the dividends per share to market price-year end; **FROA** is the percentage of net income to total assets; **FTOBIN** is the market value of equity plus total debts to total assets; **FRETURN** is the annual (end-of-year) geometric stock rate of return; **FPRICE** is the firm's year-end share price; **FAGE** is the firm's establishment age.

Furthermore, the other four categories are negatively associated with CGSCORE but with no statistical significance, which means such shareholders, especially managerial/insider shareholders (MAJOR7), are not interested in CG practices included in this score. This finding fails to support the empirical results of Giannetti and Simonov (2006) that indicated insiders are attracted to invest in firms with poor CG quality. The study claims that insiders have the ability to control shareholder for the sake of their own interests. In other words, managers and directors are always able to obtain private information about their respective companies, so in the case of poor CG practices they still have access to such information to protect their rights and interests.

In regard of variables of board quality, categories of major shareholders are significantly and negatively associated larger boards (BODSIZE) except for MAJOR5 and MAJOR7 which showed no significant association. Board independence (BODINDP) has also a negative relationship to the eight categories except for managerial/insider shareholdings, which interestingly shows a significant and positive association with having independent members in boards. Additionally, both MAJOR2 and MAJOR4 strongly prefer more board meetings to be held throughout the year. Concerning the presence of members of the royal family in boards, the regression results reveal that MAJOR4, MAJOR5 and MAJOR8 have a significant negative relationship with BODROYAL. Royal investors seem to avoid investing in companies where another competing member of the royal family is present. Major shareholdings of governmental institutions, however, have an insignificant and positive relationship with BODROYAL. This finding does not support the results of Falgi (2009) and Al-Matari et al. (2012) which claim that the presence of royal directors in investee firms' boards is strongly preferred by governmental institution due to their solid ties.

In respect of control variables, the findings in Table 6.5 reveal that wealthy families, governmental institutions, funds and royal investors prefer to invest in large companies as suggested by Gompers and Metrick (2001) and Hawas and Tse (2016) while insiders are the only category with a negative relationship with FSIZE but statistically insignificant. MAJOR2 and MAJOR7 seems to strongly favour companies with high liquidity (Share turnover) whereas the coefficients of MAJOR1, MAJOR3, MAJOR6 and MAJOR8 are statistically significant and negatively related to this firm characteristic, which fail to provide an evidence to support the findings of Huang (2008) that suggested institutional investors prefer to invest in companies with high liquidity. On a theoretical level, higher liquidity motivates shareholders to purchase such shares which can be sold more easily. This in turn reduces major shareholders incentives to monitor since they can sell their shares quicker (Maug, 1998). As previously mentioned, Al-Janadi et al. (2016) indicated that government ownership in Saudi potential investee firms is

unfavourable for investors. Additionally, the Saudi capital market is characterised with higher liquidity, which is linked, in part, to large stakes owned by insiders (Fallatah & Dickins 2012). This explains why MAJOR2 and MAJOR7 are positively and significantly related to FTURN. The results here showed that MAJOR2 (Governmental Institutions) prefer companies with higher liquidity (Share turnover), which can be described as if MAJOR2 prefer to make their investee firms, that has higher liquidity, unattractive to other major shareholders. It also can indicate, intuitively, that governmental institutions and insiders have heavily controlled and invested in firms with higher liquidity which explains the negative significant relationship between the other four categories of major shareholders and FTURN.

Moreover, the results indicate that most major shareholders categories lean toward firms with less dividend payout, particularly funds and insurance firms, which is the case in the UK as reported by Hawas and Tse (2016). In regard of firm performance, there are no significant relationships between the eight categories and FROA and FTOBIN except of wealthy families who are significantly negatively associated with FROA whilst wealthy individuals are significantly and positively associated with FROA. Besides, FTOBIN is only significantly and negatively related to MAJOR5 and MAJOR6 which means they do not tilt their portfolio towards overvalued firms (Tobin's Q). MAJOR3, MAJOR7 and MAJOR8 results reveal a negative relationship to FTOBIN too but with no economical magnitude, which is similar to the results of Chung and Zhang (2011) that found a negative relationship between institutional investors and Tobin's Q of investee companies.

In addition, the findings of the regression models indicate that FRETURN have a significant and negative association with the shareholdings of MAJOR2 and MAJOR4, which supports the results of Hawas and Tse (2016), whereas the variable coefficient is significant and positively related to MAJOR6. Share price of investee firms seem to be positively linked to the major shareholdings of all seven types apart from wealthy families (MAJOR1) and funds and insurance firms (MAJOR6) as they are evidently not influenced by such information. Finally, older investee companies do not seem to be in favour of the interests of a number of major shareholder types such as insiders and royal investors as they are significantly and negatively related to it. However, the results show that wealthy individuals are attracted to older established firms.

6.5 Summary of the Regression Analysis Findings

6.5.1 CG and Total Major Shareholdings

The following bullet points summarise the regression results of the relationship between CG and total major shareholdings in the Saudi capital market:

- The regression analysis has shown a significant negative relationship between CG score (provisions for shareholders' rights and general assembly) of investee firms and total major shareholdings.
- Total major shareholdings are also significantly and negatively related to large boards, presence of independent and non-executive directors whereas they have a significant positive relationship with board meetings, which is consistent with prior studies that found investors are interested in such characteristics on boards (Ferreira and Matosm, 2008; Giannetti and Simonov, 2006; Khurshed et al., 2011).
- Major shareholdings have a significant and positive relationship with large firms, which is in line with the findings of Gompers and Metrick (2001).
- Unlike the findings of previous studies (i.e. Falkenstein, 1996; Huang, 2009), major shareholders in Saudi Arabia avoid investing in companies with high liquidity (Share turnover).

6.5.2 CG and Major Shareholdings Except of Wealthy Families

The following bullet points presents a summary of the significant regression results of the relationship between CG and major shareholdings excluding wealthy families holdings:

- Total major shareholdings except of wealthy families' have shown a positive relationship with CG score but statistically insignificant. However, this sample of major shareholdings have also shown a significant negative relationship with large boards and higher number of independent members.
- The only board quality variable that is positively and significantly related to this sample is board meetings whereas other variables namely NEDs and presence of royal board members have no significant relationship with this sample.

6.5.3 CG Preferences of Different Categories of Major Shareholders

The regression analysis has found distinct CG preferences among different categories of major shareholders namely wealthy families, governmental institutions, other institutional investors, financial firms, wealthy individuals, fund and insurance firms, insiders, and royal investors (see Table 6.6). The following sections summarise the findings of their regression tests.

6.5.3.1 Wealthy Families (MAJOR 1)

The main category that is significantly and negatively associated with CG score and board quality variables is wealthy families. Statistically, they showed their dislike for provisions of shareholders' rights and general assembly, large boards, independent boards, NEDs, and royal members. This is consistent with Aleshaikh (2018) that found families tend to enforce their control over the board composition. Additionally, these results are consistent Al-Assaf et al. (2017) which reported that the independent members are the least favourable component of wealthy families. The only variable that has a significant positive relationship with this category is firm size, which indicates that such families tend to tilt their portfolios toward larger firms.

6.5.3.2 Governmental Institutions (MAJOR 2)

Major shareholdings of the government have shown no significant relationship with CG score, independence, NEDs and royal board members. However, they prefer to invest in large firms with small boards, low returns, and high turnover. Also, they are significantly and positively associated with board meetings.

6.5.3.3 Other Institutional Investors (MAJOR 3)

The regression analysis has revealed that CG structure in investee firms has no significant relationship with major shareholdings of other institutional investors except for board size as such investors significantly avoid investing in firms with large boards. In relation to control variables, this category is significantly and negatively related to firms with high turnover,

however, other firm characteristics have no significant impact on major shareholdings of this category.

6.5.3.4 *Financial Firms (MAJOR 4)*

Major shareholdings of this category showed a significant and negative relationship with large boards and the presence of royal members in such boards. On the other hand, financial firms prefer higher number of board meetings in companies with higher share prices and lower returns. No significant relationship is found between financial firms' holdings and CG score, independence, and NEDs.

6.5.3.5 *Wealthy Individuals (MAJOR 5)*

This research revealed that wealthy individuals are significantly and positively related to CGSCORE which indicate that such investors ensure that they invest in companies that comply with provisions of shareholders' rights and general assembly. However, they significantly dislike investing in companies whose boards consist of members of the royal family. The regression results also indicated that wealthy individuals have shown their preference in investing in old firms with higher leverage, ROA and share price.

6.5.3.6 *Fund and Insurance Firms (MAJOR 6)*

The regression analysis has indicated that major shareholdings of funds and insurance firms have a significant negative relationship with large board, NEDs, leverage, turnover, dividends, Tobin's Q and share price. On the other hand, they prefer to invest in larger firms with higher share returns. The results showed no significant relationship between fund and insurance firms and CG score, board independence, board meetings and presence of royal board members.

6.5.3.7 *Insiders (MAJOR 7)*

The regression test has found that major shareholdings of this category is positively and significantly related to independent boards and firms with higher turnover. The results showed, however, that insider shareholders significantly avoid investing in old firms. No significant relationship has been found with the rest of CG and control variables.

6.5.3.8 *Royal Investors (MAJOR 8)*

This category of major shareholders seems to have a significant negative relationship with companies that have larger boards consisting of mostly NEDs and the presence of royal board members. The regression findings have shown no significant relationship between royal investors and CG score, board independence, and board meetings. However, they are significantly and negatively associated with old companies and high turnover.

| Independent Variable | Nature of Relationship | |
|--------------------------------------|----------------------------|-------------------------------------------------------------------------------|
| | Significant Positive | Significant Negative |
| MAJORHOLD (Total Sample) | BODMEET FSIZE | CGSCORE BODSIZE BODINDP BODNEDS FLEV FTURN FDY FAGE |
| MAJORHOLD (Non-family Sample) | BODMEET FSIZE FTOBIN | BODSIZE BODINDP FLEV FTURN FDY |
| MAJOR1 | FSIZE | CGSCORE BODSIZE BODINDP BODNEDS BROYAL FTURN FROA FPRICE |
| MAJOR2 | BODMEET FSIZE FTURN | BODSIZE FRETURN |
| MAJOR3 | N/A | BODSIZE FTURN |
| MAJOR4 | BODMEET FPRICE | BODSIZE BODROYAL |

| Independent Variable | Nature of Relationship | |
|----------------------|-------------------------------------------|---------------------------------------------------------|
| | Significant Positive | Significant Negative |
| | | FRETURN |
| MAJOR5 | CGSCORE FLEV FROA FPRICE FAGE | BODROYAL FTOBIN |
| MAJOR6 | FSIZE FRETURN | BODSIZE BODNEDS FLEV FTURN FTOBIN FPRICE |
| MAJOR7 | BODINDP FTURN | FAGE |
| MAJOR8 | FSIZE | BODSIZE BODNEDS BODROYAL FTURN FAGE |

Table 6.6: Summary of Significant Relationships Between Dependent and Independent Variables

To sum up, the quantitative assessment shows that the most variables that significantly and negatively affect shares selection of total major shareholdings are CG score, board size, leverage, firm turnover and age. On the contrary, NEDs, board meetings, firm size and Tobin's are the most variables that have a significant and positive relationship with shares selection of total major shareholders in the Saudi capital market. The regression analysis has also revealed that the variables that are not preferred by the different categories of major shareholders are large board (75%), NEDs (37.75%), royal board members (50%), and firm turnover (50%). Table 6.7 presents (in percentage) the variables that major shareholders categories statistically prefer or avoid during shares selection.

| VARIABLE | PREFERRED | | NOT PREFERRED | |
|----------------|------------|------------|---------------|------------|
| | PERCENTAGE | CATEGORY | PERCENTAGE | CATEGORY |
| CG SCORE | 12.5% | 1 out of 8 | 12.5% | 1 out of 8 |
| BOARD SIZE | 0% | None | 75% | 6 out of 8 |
| INDEPENDENCE | 12.5% | 1 out of 8 | 12.5% | 1 out of 8 |
| NEDS | 0% | None | 37.75% | 3 out of 8 |
| BOARD MEETINGS | 25% | 2 out of 8 | 0% | None |
| ROYAL MEMBERS | 0% | None | 50% | 4 out of 8 |

| VARIABLE | PREFERRED | | NOT PREFERRED | |
|------------------|------------|------------|---------------|------------|
| | PERCENTAGE | CATEGORY | PERCENTAGE | CATEGORY |
| FIRM SIZE | 37.75% | 3 out of 8 | 0% | None |
| LEVERAGE | 12.5% | 1 out of 8 | 12.5% | 1 out of 8 |
| TURNOVER | 25% | 2 out of 8 | 50% | 4 out of 8 |
| DIVIDENDS | 0% | None | 12.5% | 1 out of 8 |
| ROA | 12.5% | 1 out of 8 | 12.5% | 1 out of 8 |
| TOBIN'S Q | 0% | None | 25% | 2 out of 8 |
| RETURN | 12.5% | 1 out of 8 | 25% | 2 out of 8 |
| PRICE | 25% | 2 out of 8 | 25% | 2 out of 8 |
| FIRM AGE | 12.5% | 1 out of 8 | 25% | 2 out of 8 |

Table 6.7: CG Preferences of Major Shareholders Categories

Note: the percentage is calculated based on the number of relevant categories divided by the total number of categories.

6.6 Robustness Checks

This thesis employs a series of robustness checks that are related to the main regression model to examine whether the results are rigorous. It is argued that there is always a possibility that the independent variables in corporate governance studies are endogenous (Bhagat and Bolton, 2008). An endogenous variable is defined by Vogt. W. Paul (1999, p.101) as: “a variable that is an inherent part of the system being studied and the value of which is determined within the system. This variable is caused by other variables in a causal system. It is contrasted with an exogenous variable. An exogenous variable is a variable entering from and determined from the outside of the system being studied”. Green (2003) states that multiple regression models can produce inconsistent and biased outputs of the casual effect of the independent variables on the dependant variable. This means that other variables that are linked with the independent variables may be indirectly associated with the interpretation of the dependant variable. Additionally, Van Lent (2007) and Ntim et al. (2012b) indicate that the endogeneity problem arises if the error term is highly correlated to the dependant and independent variables. According to Wintoki et al. (2009), many studies reported at least two possible causes of endogeneity that can compromise statistical findings namely: simultaneity and unobservable heterogeneity. Consequently, this thesis addresses the potential endogeneity problems as an attempt to ensure the robustness and consistency of results by employing different statistical

and econometric methods. The following sub-sections presents the endogeneity and sensitivity tests that are performed by the researcher.

6.6.1 Endogeneity Tests

This research performs Hausman test that assigns the best model to be selected based on the data used (Wooldridge, 2003). The aim of performing this model is to control for the problem of endogeneity and to address issues of unobservable effects that are unlikely to be captured by the pooled OLS regression (Black et al., 2006). It is stated that the techniques of panel data regression include more observations and has the ability to control fixed effects by enabling the researcher account for the differences between firms, which in turn would mitigate the problem of producing biased outputs (Baltagi, 2008).

The output of Hausman test indicates that the fixed effects model is more appropriate. Table 6.8 presents the regression results of fixed effects and random models as well as the Hausman test. The results show minor differences between the fixed effects model and the pooled OLS regression presented earlier in Table 6.4. The relationship between major shareholdings and CGSCORE is still negative and significant. Some board quality mechanisms have become insignificantly linked to major shareholdings but in general it can be stated that the results of the fixed effect model support the earlier results of the pooled OLS regression.

| Variables | Fixed Effects | Random Effects |
|------------------|----------------------|-----------------------|
| <i>CGSCORE</i> | -0.051** (0.026) | -0.008 (0.025) |
| <i>BODSIZE</i> | -0.003** (0.009) | -0.001 (0.007) |
| <i>BODINDP</i> | -0.02 (0.083) | 0.052 (0.076) |
| <i>BODNEDS</i> | -0.074** (0.088) | 0.179** (0.075) |
| <i>BODMEET</i> | 0.001 (0.004) | 0.000 (0.003) |
| <i>BODROYAL</i> | -0.018 (0.020) | -0.018 (0.029) |
| <i>FSIZE</i> | 0.058** (0.030) | 0.032 (0.021) |
| <i>FLEV</i> | -0.270** (0.118) | 0.188*** (0.058) |
| <i>FTURN</i> | -0.001*** (0.001) | -0.002 (0.001) |
| <i>FDY</i> | -0.001 (0.002) | -0.001 (0.002) |
| <i>FROA</i> | 0.069** | 0.130*** |

| Variables | Fixed Effects | Random Effects |
|----------------|---------------|----------------|
| | (0.031) | (0.040) |
| <i>FTOBIN</i> | -0.254 | -0.123** |
| | (0.093) | (0.053) |
| <i>FRETURN</i> | 0.026 | 0.007 |
| | (0.015) | (0.014) |
| <i>FPRICE</i> | 0.000 | -0.000 |
| | (0.000) | (0.000) |
| <i>FAGE</i> | -0.018 | 0.001 |
| | (0.004) | (0.001) |
| _cons | 0.050 | 0.354*** |
| | (0.213) | (0.118) |
| Observations | 485 | 485 |
| R-squared | 0.270 | 0.143 |

Hausman Test:
b = consistent under *H*₀ and *H*_a; obtained from *xtreg*
B = inconsistent under *H*_a, efficient under *H*₀; obtained from *xtreg*
Test: *H*₀: difference in coefficients not systematic
 $\chi^2(15) = (b-B)'[(V_b-V_B)^{-1}](b-B)$
= 62.06
Prob> χ^2 = 0.0000
(V_b-V_B is not positive definite)

Robust standard errors are in parentheses *** $p < .01$, ** $p < .05$

Table 6.8: Regression Results of Fixed Effects and Random Effects Models

CGSCORE is the total score of the CG index; **BODSIZE** is the number of board members; **BODINDP** is the number of board independent members; **BODNEDS** is the number of board NEDs; **BODMET** is the number of annual board meetings; **BODROYAL** is 1 (if a royal member exists in the boards), 0 otherwise; **FSIZE** is the firm's market value; **FLEV** is the percentage of total debt to total assets; **FTURN** is the annual share volume over the year to share outstanding; **FDY** is the dividends per share to market price-year end; **FROA** is the percentage of net income to total assets; **FTOBIN** is the market value of equity plus total debts to total assets; **FRETURN** is the annual (end-of-year) geometric stock rate of return; **FPRICE** is the firm's year-end share price; **FAGE** is the firm's establishment age.

Moreover, following Black et al. (2006), this thesis selected a number of control variables to mitigate the problem caused by omitted variables and produce results that are not affected by endogeneity (see Table 6.4). In addition, the main regression model has been re-run to investigate the CG preferences of each category of major shareholders in order to address heterogeneity across major shareholders (see Table 6.5). All multiple regressions performed by this study have included a robust standard error. Hoechle (2007) points out that robust standard errors are commonly included in regression models to ensure the validity of the statistical inference.

In line with Larcker and Rusticus (2010) and Stiebale (2011), an econometric method is employed in this thesis to reduce the simultaneity problem between CG and major shareholdings by using lagged values of CG variables (t-1). Similarly, Cornett et al. (2008) pointed out that the relationship between institutional investors and accrual policy is highly expected to be affected by a simultaneity problem. Thus, this thesis has re-run the main regression model by using lagged values (t-1) of CG to minimise potential simultaneity problems between major shareholdings and CG. Table 6.9 presents Model 1-10 which represent the regression results of total sample, non-family sample and each category of major shareholders, respectively. As shown in Table 6.9 Model 1, the coefficient signs and significance levels of CG variables supports the earlier results presented in Table 6.4 except of the significance level of BODNEDS which has become significantly associated with major shareholdings.

Regarding the eight categories of major shareholders, most of the regression results are in line of the earlier results shown in Table 6.5. However, it seems that few shareholders in Table 6.9 have shown different directions of the relationship with CG variables. For instance, the relationship between MAJOR 3 and CGSCORE has become negative, but insignificant. Additionally, MAJOR 7 has become significantly and negatively associated with CGSCORE where in Table 6.5 they were insignificantly associated. Hence, the use of lagged values of CG in the regression models has shown no major differences compared to the use of the current CG values of every year included in the regression tests.

| Variables | (1) Total Sample | (2) Partial Sample | (3) MAJOR 1 | (4) MAJOR 2 | (5) MAJOR 3 | (6) MAJOR 4 | (7) MAJOR 5 | (8) MAJOR 6 | (9) MAJOR 7 | (10) MAJOR 8 |
|---------------------|------------------------|--------------------------|--------------------|-------------------|-------------------|-------------------|--------------------|---------------------|--------------------|--------------------|
| <i>LAG_CGSCORE</i> | -.179*** (.053) | -.056 (.064) | -.536*** (.094) | -.201 (.141) | -.002 (.135) | -.025 (.016) | .229*** (.058) | -.035 (.088) | -.309** (.122) | .087 (.108) |
| <i>LAG_BODSIZE</i> | -.022*** (.006) | -.007 (.006) | -.057*** (.014) | -.06*** (.013) | -.04*** (.012) | -.005** (.002) | -.023*** (.008) | -.015 (.008) | .018 (.018) | -.074*** (.019) |
| <i>LAG_BODINDP</i> | -.158 (.104) | .041 (.116) | -.655*** (.189) | -.32 (.304) | -.204 (.298) | -.004 (.031) | -.097 (.121) | -.186 (.215) | .31 (.26) | -.649** (.245) |
| <i>LAG_BODNEDS</i> | .201** (.094) | .077 (.099) | -.436*** (.153) | -.158 (.258) | .095 (.295) | .007 (.024) | .03 (.092) | -.279 (.2) | .382 (.248) | -.658*** (.148) |
| <i>LAG_BODMEET</i> | .015*** (.004) | .005 (.005) | -.005 (.007) | .031*** (.008) | .012 (.012) | .002 (.002) | .001 (.006) | -.005 (.006) | 0 (.017) | -.001 (.005) |
| <i>LAG_BODROYAL</i> | .041** (.019) | -.051** (.02) | -.157** (.065) | .071 (.066) | .019 (.047) | -.016 (.01) | -.032 (.017) | -.034 (.042) | .041 (.059) | -.351*** (.095) |
| <i>FSIZE</i> | .112*** (.02) | .177*** (.021) | .113** (.049) | .138** (.059) | .028 (.06) | .004 (.007) | 0 (0) | .259*** (.058) | -.09 (.069) | .19*** (.042) |
| <i>FLEV</i> | -.233** (.118) | -.432*** (.158) | -.069 (.105) | .077 (.161) | .162 (.194) | -.009 (.021) | .445*** (.1) | -1.587*** (.409) | .112 (.231) | .236 (.174) |
| <i>FTURN</i> | -.005** (.002) | -.002 (.002) | -.012** (.006) | .026** (.013) | -.01 (.007) | .001 (.001) | .006 (.004) | -.002 (.001) | .015 (.008) | -.005 (.004) |
| <i>FDY</i> | -.002 (.004) | -.013*** (.005) | .003 (.006) | -.006 (.01) | -.012 (.009) | -.001 (.001) | -.006 (.004) | -.02*** (.007) | .002 (.007) | .001 (.006) |
| <i>FROA</i> | .013 (.091) | .094 (.1) | -.136 (.143) | .131 (.284) | -.175 (.221) | -.012 (.017) | .257*** (.088) | -.057 (.099) | -.613 (.499) | -.306 (.206) |
| <i>FTOBIN</i> | .219** (.103) | .36*** (.138) | .007 (.081) | .029 (.128) | -.206 (.112) | .011 (.012) | -.324*** (.091) | -.322*** (.073) | -.218 (.211) | -.186 (.152) |
| <i>FRETURN</i> | .013 (.028) | -.003 (.033) | .093 (.065) | -.102 (.067) | -.031 (.053) | -.012** (.006) | -.001 (.041) | .06** (.03) | .094 (.093) | .133** (.053) |
| <i>FPRICE</i> | .001 (0) | .001*** (0) | -.001 (.001) | .002 (.001) | .001 (.001) | 0 (0) | 0** (0) | -.001 (.001) | 0 (.001) | .002 (.001) |
| <i>FAGE</i> | -.002*** (.001) | -.002** (.001) | 0 (.001) | 0 (.001) | -.002 (.002) | 0 (0) | .001 (.001) | .008 (.008) | -.004*** (.001) | -.007*** (.002) |
| _cons | .323** (.134) | -.05 (.145) | 1.6*** (.177) | .471 (.445) | .778** (.367) | .178*** (.052) | .107 (.124) | .111 (.401) | .441 (.214) | 1.155*** (.302) |
| Observations | 388 | 280 | 108 | 140 | 108 | 64 | 72 | 56 | 40 | 36 |
| R-squared | .503 | .55 | .708 | .405 | .343 | .466 | .621 | .83 | .765 | .988 |
| Year Dummy | YES | YES | YES | YES | YES | YES | YES | YES | YES | YES |

Robust standard errors are in parentheses

*** $p < .01$, ** $p < .05$

Table 6.9: Regression Results of Major Shareholders and Lagged CG Variables

LAG_CGSCORE is the lagged values (t-1) of total score of the CG score; **LAG_BODSIZE** is the number of board members (t-1); **LAG_BODINDP** is the number of board independent members (t-1); **LAG_BODNEDS** is the number of board NEDs (t-1); **LAG_BODMEET** is the number of annual board meetings (t-1); **LAG_BODROYAL** is 1 (if a royal member exists in the boards), 0 otherwise; **FSIZE** is the firm's market value; **FLEV** is the percentage of total debt to total assets; **FTURN** is the annual share volume over the year to share outstanding; **FDY** is the dividends per share to market price-year end; **FROA** is the percentage of net income to total assets; **FTOBIN** is the market value of equity plus total debts to total assets; **FRETURN** is the annual (end-of-year) geometric stock rate of return; **FPRICE** is the firm's year-end share price; **FAGE** is the firm's establishment age.

6.6.2 Sensitivity Tests

This thesis has also used additional variables namely year and industry as dummy variables. The purpose of using year as a dummy variable is to control for time trends (market-wide effects) whereas the purpose of using the industry-specific dummy is to highlight any preferences of major shareholders for specific industries. It is reported that ownership concentration is possible to be different across industries (Grosfeld and Hashi, 2005). Table 6.10 presents the regression results of both total sample (Models 1-2) and the non-family sample (Models 3-4) with using year and industry as dummy variables as well as a robust standard error. The first model of each sample uses no dummy variables while the second model uses both dummy variables. The R^2 and coefficient values of CGSCORE and most of other variables have notably changed. For instance, the R^2 of the total sample has increased from 0.353 to 0.489 and the R^2 of the non-family sample has increased from 0.431 to 0.562. This indicates that the unobserved heterogeneity had a big effect on the results. However, the results of this additional test, regarding the signs of the relationships between MAJORHOLD and independent variables, appear to support most of the earlier results shown in Table 6.4, therefore, confirming the robustness of the main regression results.

| Variables | Total Sample | | Non-Family Sample | |
|-----------------|--------------------|--------------------|--------------------|--------------------|
| | (Model 1) | (Model 2) | (Model 3) | (Model 4) |
| <i>CGSCORE</i> | -.143** (.061) | -.156*** (.052) | .004 (.074) | -.054 (.069) |
| <i>BODSIZE</i> | -.018*** (.005) | -.02*** (.005) | -.014** (.006) | -.017*** (.006) |
| <i>BODINDP</i> | -.444*** (.087) | -.142 (.094) | -.305*** (.102) | -.24** (.094) |
| <i>BODNEDS</i> | -.149** (.075) | .192** (.086) | -.119 (.092) | -.042 (.088) |
| <i>BODMEET</i> | .011*** (.004) | .013*** (.004) | .011** (.005) | .014*** (.005) |
| <i>BODROYAL</i> | .021 (.017) | .044** (.018) | .024 (.018) | .032 (.019) |
| <i>FSIZE</i> | .111*** (.019) | .12*** (.018) | .14*** (.02) | .157*** (.019) |
| <i>FLEV</i> | -.107** (.049) | -.251** (.1) | -.172*** (.056) | -.457*** (.109) |
| <i>FTURN</i> | -.008*** (.002) | -.005** (.002) | -.008*** (.003) | -.004 (.002) |
| <i>FDY</i> | -.009** (.004) | -.005 (.003) | -.016*** (.004) | -.01** (.004) |
| <i>FROA</i> | .025 (.068) | .051 (.069) | .111 (.07) | .105 (.073) |
| <i>FTOBIN</i> | .055 (.04) | .227*** (.085) | .109*** (.041) | .354*** (.101) |
| <i>FRETURN</i> | .011 (.027) | .007 (.025) | .016 (.03) | -.001 (.027) |

| Variables | Total Sample | | Non-Family Sample | |
|----------------|--------------------|--------------------|-------------------|--------------------|
| | (Model 1) | (Model 2) | (Model 3) | (Model 4) |
| <i>FPRICE</i> | 0 (0) | .001 (0) | 0 (0) | .001*** (0) |
| <i>FAGE</i> | -.002*** (.001) | -.002*** (.001) | -.002 (.001) | -.002*** (.001) |
| _cons | .712*** (.121) | .297** (.126) | .355** (.141) | .245 (.135) |
| Observations | 485 | 485 | 350 | 350 |
| R-squared | .353 | .489 | .431 | .562 |
| Year Dummy | NO | YES | NO | YES |
| Industry Dummy | NO | YES | NO | YES |
| VIF | 1.95 | 2.84 | 1.99 | 3.19 |

Robust standard errors are in parentheses

*** $p < .01$, ** $p < .05$

Table 6.10: Robustness Testing - Regression Results of Corporate Governance (CG) Variables and Major Shareholdings

CGSCORE is the total score of the CG score; **BODSIZE** is the number of board members; **BODINDP** is the number of board independent members; **BODNEDS** is the number of board NEDs; **BODMEET** is the number of annual board meetings; **BODROYAL** is 1 (if a royal member exists in the boards), 0 otherwise; **FSIZE** is the firm's market value; **FLEV** is the percentage of total debt to total assets; **FTURN** is the annual share volume over the year to share outstanding; **FDY** is the dividends per share to market price-year end; **FROA** is the percentage of net income to total assets; **FTOBIN** is the market value of equity plus total debts to total assets; **FRETURN** is the annual (end-of-year) geometric stock rate of return; **FPRICE** is the firm's year-end share price; **FAGE** is the firm's establishment age.

Moreover, this thesis has divided the total sample into two sub-samples representing largest and smallest firms based on their market value. The purpose of such division is to examine whether the results are driven by size effect. Bushee, Carter, and Gerakos (2013) revealed that firm size may be linked to governance sensitivity for two reasons. First, smaller companies are more likely to experience fraud incidents (Bushee and Leuz 2005). The second reason is that bigger companies are usually characterised with a more fulfilling information environment and monitored closely by analysts. As a result, Bushee, Carter, and Gerakos (2013) suggests that institutional investors who follow small cap styles are more motivated to invest in companies that are better governed. Additionally, the study found that long-term institutional investors in smaller firms are more sensitive to shareholder rights. Thus, firms whose market value equals or above the median of total sample market value is categorised as big firms whereas firms with market value lower than the median are categorised as small firms. Table 6.11 presents the results of each category within the total sample (484 observations) and the non-family sample (349 observations).

In regard of major shareholdings in the total sample (Table 6.11, Model 1-2), the regression results indicate that major shareholdings in big firms (Model 1) have a negative significant

relationship with CGSCORE which supports the results of the main regression model shown earlier in Table 6.4 Model 1. Additionally, the results of major shareholdings in big firms provides an additional support of the relationship with board quality variables as presented in Table 6.4. On the other hand, major shareholdings in small firms (Model 2) appear to be somewhat sensitive to firms' size because the relationship between CGSCORE and BODSIZE, and major shareholdings in this sample has become negatively insignificant. Additionally, their relationship with BODNEDS and BODROYAL has reversed. This indicates that major shareholders, within the Saudi capital market, who invest in smaller firms have somehow different interests in CG practices compared to major shareholders in larger firms, which supports the finding of Bushee, Carter and Gerakos (2013) that reported institutional investors sensitivity toward shareholder rights in smaller firms.

Regarding major shareholdings within the non-family sample (Table 6.11, Models 3-4), the regression results of big firms within the non-family sample have revealed that major shareholdings are negatively but insignificantly associated with CGSCORE. However, they have a significant negative relationship with BODSIZE and BODINDP. The results of small firms showed no significant relationship between major shareholdings and CG variables. Nevertheless, the relationship between major shareholdings in small firm and CGSCORE remained positive, but insignificant, which is in line with the results presented in Table 6.4. In general, this additional test has demonstrated that total major shareholdings within the Saudi capital market are not significantly sensitive to firms' size in regard to CG, which supports the robustness of the earlier regression results. However, major shareholdings within the partial sample appear to be somehow sensitive to firm size in regard to CG since their relationship with CGSCORE and a number of variables have slightly changed, which indicates that major shareholders lean toward examining CG aspects in investee firms especially small firms.

| Variables | (Model 1) | (Model 2) | (Model 3) | (Model 4) |
|----------------|--------------------|--------------------|-------------------|----------------|
| | Big Firms | Small Firms | Big Firms | Small Firms |
| <i>CGSCORE</i> | -.22*** (.069) | -.014 (.082) | -.108 (.092) | .079 (.095) |
| <i>BODSIZE</i> | -.034*** (.007) | -.011 (.007) | -.029*** (.01) | -.01 (.008) |
| <i>BODINDP</i> | -.366*** (.12) | -.361*** (.121) | -.42*** (.152) | .002 (.149) |

| Variables | (Model 1) | (Model 2) | (Model 3) | (Model 4) |
|-----------------|--------------------|--------------------|--------------------|-------------------|
| | Big Firms | Small Firms | Big Firms | Small Firms |
| <i>BODNEDS</i> | -.174** (.084) | .018 (.12) | -.17 (.113) | .19 (.15) |
| <i>BODMEET</i> | .012** (.006) | .011** (.005) | .012 (.007) | .014 (.008) |
| <i>BODROYAL</i> | .104*** (.025) | -.068*** (.024) | .088*** (.027) | -.044 (.028) |
| <i>FSIZE</i> | .113*** (.027) | .087 (.059) | .138*** (.031) | .201*** (.068) |
| <i>FLEV</i> | -.186** (.094) | -.014 (.09) | -.299*** (.092) | -.006 (.121) |
| <i>FTURN</i> | -.028*** (.01) | -.006** (.003) | -.022** (.01) | -.005 (.003) |
| <i>FDY</i> | -.014*** (.005) | -.002 (.005) | -.019*** (.007) | -.012 (.007) |
| <i>FROA</i> | -.31** (.144) | .139 (.072) | -.017 (.16) | .21*** (.073) |
| <i>FTOBIN</i> | .078 (.065) | .046 (.056) | .151** (.063) | .102 (.057) |
| <i>FRETURN</i> | .008 (.037) | -.003 (.037) | .005 (.049) | .062 (.04) |
| <i>FPRICE</i> | 0 (0) | 0 (.001) | 0 (0) | 0 (.001) |
| <i>FAGE</i> | -.001 (.001) | -.002 (.001) | -.001 (.001) | -.001 (.001) |
| _cons | .955*** (.174) | .518** (.236) | .716*** (.211) | -.191 (.267) |
| Observations | 243 | 241 | 178 | 172 |
| R-squared | .36 | .242 | .411 | .334 |

Robust standard errors are in parentheses

*** $p < .01$, ** $p < .05$

Table 6.11: Regression Results of Big and Small Firms of Total and Partial Sample

CGSCORE is the total score of the CG score; **BODSIZE** is the number of board members; **BODINDP** is the number of board independent members; **BODNEDS** is the number of board NEDs; **BODMEET** is the number of annual board meetings; **BODROYAL** is 1 (if a royal member exists in the boards), 0 otherwise; **FSIZE** is the firm's market value; **FLEV** is the percentage of total debt to total assets; **FTURN** is the annual share volume over the year to share outstanding; **FDY** is the dividends per share to market price-year end; **FROA** is the percentage of net income to total assets; **FTOBIN** is the market value of equity plus total debts to total assets; **FRETURN** is the annual (end-of-year) geometric stock rate of return; **FPRICE** is the firm's year-end share price; **FAGE** is the firm's establishment age.

6.7 Conclusion

This chapter presents the empirical results of the quantitative assessment of this research. It started by examining the important assumptions of the regression analysis such as normality, multicollinearity, linearity and heteroscedasticity. The results of these tests have shown that no major violations of normality, multicollinearity and linearity, however, the robust standard error is employed in this research to account for the presence of heteroscedasticity aiming to ease this problematic issue.

To examine the impact of CG on aggregate major shareholdings, this research uses a pooled regression model of aggregate major shareholdings as a dependant variable and CG score and board characteristics as independent variables in addition to firm characteristics as control variables. One additional sample has been created to exclude major shareholdings of wealthy families from to the total sample. Additionally, the same regression model is re-estimated by replacing aggregate major shareholdings with each category of major shareholders to examine their preferences in CG namely: wealthy families, governmental institutions, other institutional investors, financial firms, wealthy individuals, fund and insurance firms, insiders, and royal investors.

The findings indicate that aggregate major shareholdings have a significant negative relationship with CG score and board size. However, when wealthy families holdings were excluded from the sample, the relationship with CG became positive, but statistically insignificant. On the contrary, aggregate major shareholdings have a significant positive relationship with NEDs, board meetings and royal board members whereas major shareholdings with the exclusion of wealthy families became significantly and positively related board meetings only. Board size has a significant negative relationship with both samples (i.e., aggregate major shareholdings and aggregate major shareholdings excluding wealthy families).

In regard to CG preferences of different categories of major shareholders, the most major shareholders category that has a significant negative relationship with CG is the wealthy families category where they are significantly and negatively related to CG score, board size, board independence, NEDs, and royal board members.

On the other hand, the regression results have shown mixed results of the CG preferences of the rest of categories. Generally, the variables that significantly and negatively related to

categories shares selection are CG score, board size, leverage, firm turnover and age. In contrast, NEDs, board meetings, firm size and Tobin's are the most variables that have a significant and positive relationship with shares selection of total major shareholders in the Saudi capital market. The regression results have also provided evidence that the variables that are mostly avoided by the different categories of major shareholders are large board (75%), NEDs (37.75%), royal board members (50%), and firm turnover (50%).

The next chapter will present the findings of the qualitative assessment followed by an integration between the findings of both quantitative and qualitative assessments.

Chapter 7. Findings and Discussions of The Qualitative Assessment

7.1 Introduction

Chapter Six presented the findings and discussions of the regression analysis of secondary data employed in this thesis to investigate the impact of CG on shares selection of major shareholders in the Saudi capital market. This chapter, however, presents and discusses the findings of semi-structured interviews that were conducted with fifteen major shareholders within the Saudi capital market. The chapter analyses their views of CG practices in Saudi Arabia in different aspects such as CG definition, importance, mechanisms in relation to board quality and shareholders' rights, the role of major shareholders, and most importantly the impact of CG structure of potential investee firms on their investment decisions. The aim of examining primary data is to gain insightful information about the current perception of CG and its impact on shares selection of major investors in the Saudi capital market as well as supporting the results of regression analysis. This chapter presents the outcomes of these semi-structured interviews with different categories of major shareholders within the Saudi capital market, including wealthy families, governmental institutions, insiders, wealthy individuals, financial firms, funds, and other institutional investors.

As presented in Chapter Five, several broad questions were prepared and asked to participants in order to provide the researcher with their views and experience concerning the CG system in Saudi Arabia and the impact of CG structure in potential investee firms on the investment decisions of major shareholders (see Appendix A). The questions were categorised into five themes: (i) the perception of CG; (ii) the importance and compliance of CG; (iii) the perception of CG mechanisms; (iv) the role of major shareholders in the Saudi capital market; and finally (v) the effect of CG on investment decisions of major shareholders. These five themes construct the following sections of this chapter.

7.2 Perception of Corporate Governance

To begin with, until 2008 the English terminology Corporate Governance had no corresponding term in Arabic. Different parties within the field made attempts to create a matching term in Arabic but those attempts lacked clarity and had implications. For instance, the term

'Hawakamat Al Sharekaat' had been used in earlier attempts and still being used by the CMA, which is a literal translation rather than grasping the essence of the meaning of the English term (Alshehri, 2012). Therefore, interviews were initiated by asking interviewees about their definition of CG. Several interviewees define CG from major investors standpoint while it is noticed that few of them define CG from board members standpoint. The first group refer CG to a wider circle that involves issues and parties not mentioned by the second group. To illustrate, they link CG to the society standards and interests of major shareholders as well as the accountability issue. R6 states:

CG is supposed to be a development tool that can be used in the Saudi capital market to allow different stakeholders deal with boards to protect their interests Boards should expect their stakeholder's role to be active, so they can focus on achieving their objectives.

Additionally, R4 states that CG is formed of several laws and practices to protect the rights of all stakeholders and not only shareholders. He states:

When we want to protect companies, we should not concentrate on shareholders' interests only, but we should also consider other parties such as lenders and suppliers I believe CG practices should cover the issues related to these parties as well.

Two interviewees of this group indicate that CG is a collection of guidelines and regulations that control the overall path of firms which is by some means consistent with the view of Solomon (2005). R10 says:

I see CG as a collection of regulations that are linked to the board of directors and all related parties such as employees, suppliers, banks and most importantly shareholders....boards need a comprehensive framework to stick to with the intention of protecting the interests of these parties.

These responses are also supported by Dignam and Lowry (2006) who refer to CG as a collection of laws and regulations that have an impact on the way that a firm is managed and controlled as well as the nature of the relationship between the firm and its different stakeholders.

The other group focused on the relationship between agents and principals. R9 says:

CG is concerned with avoiding any conflicts between the management and shareholders I also link CG to the requirements of authorities that we are expected to obey and implement.

However, R9 states that many investors have insufficient knowledge of CG definition and objectives and urge the Capital Market Authority (CMA) to provide investors with detailed information about this field and not just certain rules. This interviewee says:

When the code was first introduced, most investors at that time were not familiar with a lot of CG issues and linkage to business Some vocabularies and topics were vague to investors and they still implement CG regulations without comprehending their essence and benefits to their businesses the CMA must organise frequent and compulsory CG seminars to explain the definition of CG and the importance of its mechanisms.

In addition, the majority interviewees mention two words in their definition of CG, which are: Management and Control. Many interviewees define CG as a system that manages and controls the entity to assist the board of directors to protect the interests of their shareholders. Two interviewees define CG as a tool to protect firms from collapsing. R14 said:

We have seen companies collapsing prior to the introduction of this issue in Saudi Arabia and when I go back and review their practices, I can notice that they were in fact in need of a professional system to protect them from collapsing And now I can see CG as a tool to ease this problematic issue.

This view is supported by Schneider and Scherer (2015) who consider CG as a tool to protect the business from the anticipated risks, which shows that investors tend to seek professional solutions to protect their interests and ensure their investee firms are also in line with proper practices for the same goal. This view seems also to be common among some interviewees as R4 indicates that the lack of adequate practices and proper guidance may lead companies to encounter risky challenges that threaten their survival. However, R11 states:

If we look back to the year of 2006 when the infamous market crash took place, we can notice good efforts that the CMA has made to the

development of CG practices in the Saudi Market since thenWe still expect more to be done from the CMA.

Other interviewees provide a similar view of the meaning of CG by inserting two Arabic expressions of CG into the discussion specifically: “Al Edarah Al Rasheedah & Hawkamat Al sharekaat”, which in their view mean a comprehensive system that controls and instructs companies toward continuity. R8 explains that CG is:

Considered as a system that presents the best practices that can lead to the long life of a business....bearing in mind that the company is expected obey the rules effectively and be proactive in promoting new rules and practices that benefits their business.

Given these perceptions of CG, it is found that some interviewees view CG in consistent with some previous work done by scholars and professional bodies in CG. As mentioned earlier in this research, the definition of CG that is reported by the Cadbury Report (1992, p. 14) states that CG is ‘the system by which companies are directed and controlled’. This definition is supported by definitions given by many interviewees who focused on the management and control of entities. This is probably caused by the fact that the Saudi code of CG was in its early days mostly affected by the UK approach of CG practices (Falgi, 2009; Alshehri, 2012). Since the definition of Sir Adrian Cadbury is one of the leading and prevalent definitions in CG, it seems that major investors in Saudi Arabia have remarkably adopted it. In the same vein, some interviewees are clearly affected by professional bodies whose work in CG are embraced by the CMA such as the OECD. This is also explained by the fact that the Saudi CGC 2006 was influenced by the OECD principles of CG as stated by (Alshehri, 2012). The definition of CG that is provided by the OECD focused on the relationship between the company top management and its shareholders and other stakeholders and how to implement laws to succeed in achieving the company’s objectives (OECD, 2004, p,11)

In conclusion, different perceptions of CG (to some extent) have been provided by interviewees which seems to be depending on their exposure to different resources of information. Some of them embrace the narrow perception of CG that views it as a tool to alleviate conflicts arising between the owners and managers, and focus on the matters linked to the protection of investors interests, which is a part of the issue of the agency theory as reported by (Olayiwola, 2010, Tricker and Tricker, 2012). Other interviewees, however, adopt the broad perception of CG which is concerned with a group of laws and regulations that manage the relationship between

an entity and its stakeholders, which is generally linked to the stakeholders' theory as explained by Becht, Bolton and Roell (2003) and Lin, Li and Bu (2015).

7.3 The Importance and Compliance of Corporate Governance

Prior studies of CG have argued that stakeholders' awareness of CG importance is crucial for the formation of good CG policies, especially shareholders who can assist corporate boards in implementing such practices in an effective way (Sternberg, 1997; Clarke, 1998). As shown in Chapter Four, the issuance of the Saudi CGC 2006 was a reaction to the unpredicted plunge of the Saudi capital market in February 2006. R14 states that:

One of the most noticeable consequences of this crash in the market was the loss of investors' confidence, therefore, the CMA sensed the urge to adopt CG policies that were already introduced around the world especially in the US and UK.

This response is consistent with the work of Falgi (2009) whose interviewees indicated similar view of the necessity of the CGC 2006. R7 responds to this point by saying:

The CMA would not be able to introduce the code unless it reviews the codes of famous bodies in this field such as Cadbury and OECD and some known business consultants.

This point leads to Koraytem (2000) which reports that the Saudi Arabian law is classified as a civil law where the laws of the protection of shareholders' interests lack weaknesses as stated in La Porta et al. (1999). As a result, the UK approach of the comply or explain approach was first suggested in the CGC 2006 and a number of subsequent modified versions. Two interviewees, however, disagree with this approach as they believe that many Saudi investors/companies disregard voluntarily approaches within their businesses. R15 says:

In the Saudi market, the social and cultural norms have an influence on the way companies follow the voluntary practices.... voluntarily guidelines are not deemed important unless they are enforced by law Many corporations delayed the implementation of many provisions of the code because of this reason.

Comprehending the importance of CG practices leads to better CG regulations (Sternberg, 1997; Clarke, 1998). Corporate awareness of the advantage of implementing good CG practices is important to enhance their transparency and disclosures. Three interviewees share similar views regarding the control and monitoring systems in listed companies. R2 states:

As board members we have been aware of the issues related to having bad CG practices in listed firms ... our control and monitoring activities have improved over the years.

R8 adds on:

Being an investor in a number of firms, I have seen many changes in recent years on the management attitude toward their control system ... the reporting approach has definitely changed as we suffered in earlier years with the lack of capability in the way companies issue reports.

This leads to the issue that is most important to major shareholders which is the quality of firms' disclosure from which they suffered prior to the enforcement of the Saudi code of CG.

R7 indicates:

Many investors struggled in getting the right information at the right time ... Financial Statements were poorly prepared in the past with only financial information although these were the most important content that investors were looking for, but other information of the firm were hard to obtain unless you are closely tied with the management.... the effect of CG regulations is witnessed now.

R4 highlights:

When comparing the content of financial statements in years prior to 2006 and the years following, differences are clear since the CMA have developed its Listing Rules and CG laws ... it enabled boards to have an improved comprehension of their responsibilities.

This is consistent with Soobaroyen and Mahadeo (2012) which indicated that board of directors in emerging markets have become more aware of their responsibilities after the developments of CG practices and regulations in their respective countries. In addition, interviewees have expressed their observations of other aspects that have been enhanced since the issuance of the

Saudi code of CG especially after releasing the modified CGC 2006 in 2012. Such enhancements include number of board meetings and communication methods. However, three interviewees still believe that the CMA is expected to make more efforts in increasing the awareness of boards in regard to CG practices.

In the same vein, three interviewees states that they witnessed companies adopting internal CG practices before even the CGC 2006 was introduced. They indicate that probably they needed to go on IPO, therefore, an internal code was needed in order to efficiently complete the IPO process. This response is supported by the work of Cuervo and Villalonga (2000) and Aguilera and Cuervo-Cazurra (2004) who revealed that companies tend to firmly implement lawful CG regulations or even produce internal CG policies for their own use to complete the IPO procedures efficiently. The rest of interviewees affirm the compliance with the code of CG introduced by the CMA. R3 states:

When the code was first introduced, it was not fully adaptable in the Saudi business society its cultural and environmental characteristics are different from the ones in developed countries.

However, many interviewees agree on the effectiveness of the penalties that were announced to be imposed on firms that are not in compliance with the code mandatory provisions. R5 states:

Many boards and committees have been re-appointed in line with the new or revised policies in regard of their size and independence and composition.

To sum up, interviewees responses indicate that shareholders awareness of CG importance has improved intensely over the recent years. They believe that such improvement would encourage authorities for more CG reforms and development. A fair proportion of interviewees realise that shareholders awareness of their legal rights is a way of placing pressure on firms to implement good CG practices, which means exercising their rights as shareholders forces firms to meet their obligations toward good governance. This is in line with Alshehri and Solomon (2012) which revealed the Saudi steps toward CG reforms are supposed to pay more attention to enhancing stakeholders CG awareness within the capital market. Table 7.1 presents the most used terms in defining CG and its importance by major shareholders.

| Term | Interviewees | |
|-------------------------|--------------|-----|
| | No. | % |
| Protection of Interests | 13 | 86% |
| Control | 9 | 60% |
| Accountability | 4 | 26% |
| Board of Directors | 10 | 66% |
| Stakeholders | 3 | 20% |
| System | 11 | 73% |
| Guidelines | 2 | 13% |
| Agency Relationship | 6 | 40% |
| Society | 6 | 40% |
| Management | 10 | 66% |
| Sustainability | 5 | 33% |

Table 7.1: Terms Used in Defining Corporate Governance

Source: constructed by the researcher

7.4 The Perception of Corporate Governance Mechanisms

7.4.1 Overview

This section presents interviewees perception of the different CG mechanisms imposed by the Saudi CGC 2006. According to Cadbury (1992) and OECD (2004), codes must focus on the necessity of fair proportions of executives and NEDs sitting in companies board aiming to improve their ability to fulfil dedicated responsibilities. The CG mechanisms that are discussed in this section are related to two main groups that are consistent with the two groups of CG mechanisms employed in the quantitative analysis of this research. The two groups are: (i) Board of Directors and (ii) Shareholders Rights and the General Assembly. Nevertheless, interviewees were free to discuss other mechanisms of their choice.

7.4.2 Board of Directors

The recent financial crises that arose in different parts around the world have steered major investors to examine CG structure of their investee firms (Mallin, 2016). According to the OECD (2011), institutional investors have contributed to the rise in investment growth throughout the recent decades and were influential players in forming the notion that good CG is essential in investee firms. Board of directors are deemed to be the most important and active

internal governance mechanism where vital decisions are made in relation to firm existence and success (Bebchuk and Weisbach, 2010; Solomon, 2013; Mallin, 2016). Therefore, major shareholders are expected to ensure that the characteristics of their investee are appropriate and acceptable before making an investment decision. According to McCahery et al. (2016), CG is one of the persuasive factors that major investors examine to maintain their portfolio as healthy as possible. Additionally, the study has reported that major investors are also willing to have a dialogue about CG structure with corporate boards, especially in relation to their long-term investments. In fact, a survey of 200 institutional investors revealed that corporate board is considered as important as financial information (Coombes and Watson, 2000), which is also in line with various studies that found major investors lean toward investing in firms with well-composed boards (i.e. Useem et al., 1993; Chung and Zhang, 2011; Schnatterly and Johnson, 2014).

Due to a great deal of CG literature calls for more understanding of corporate board behaviour, further attention has been paid on characteristics of corporate boards (Soobaroyen and Mahadeo, 2012). As demonstrated earlier, the structure of board of directors is considered a crucial factor in its effectiveness (Jensen and Meckling, 1976; Allegrini and Greco, 2013). Given this, interviewees were asked about their perception of CG mechanisms that relate to the board of directors such as: board composition and independence, board size, and board sub-committees.

7.4.2.1 Board Composition and Independence

Most of interviewees assert that their boards mostly consist of NEDs. R10 believes that the culture of the Saudi capital market has been supporting such composition for years even before the introduction of the CGC 2006. R6 states:

Executives, as members of boards, do not usually outnumber NEDs since the business and investment culture in the Saudi capital market disallowed them from being a significant part of boards.

Three interviewees in fact oppose the appointment of executives on boards since they own the information flow of the business more than NEDs do, hence, they gain this privilege and have an impact on board decisions. In contrast, R3 disagrees with this viewpoint and states:

All board members have access to all needed information of the business....They are equally important to the entity and there is no justification to hold important data from any board memberEven the information that is analysed for decision making during meetings are provided to all board members in advance.

Overall, most interviewees agree on the importance of the board composition of NEDs exclusively and assume they would be trustworthy of shareholders' interests. Nonetheless, two interviewees insist on the importance of CEOs presence on boards. R1 argues:

CEOs have the competence and knowledge of the business more than other members Usually the owners/founders have confidence in CEOs more than NEDs in achieving their business objectives.

This view is also supported by R2 who states:

Executives are not selected as board members unless the board can rely on their ability to run the business and enhance board discussions with their experience and skills.

On the aspect of family companies, some interviewees do not consider board members of such companies as NEDs even if they are categorised as so. The reason for such general conception is revealed by R13 who says:

Family members who are NEDs on those boards are more involved in their business detailed aspects, so they sort of attend meetings with prepared agenda and decisions to be vaguely discussed and eventually get them approved on such meetings, thus, other board members become detached from the process of making strategic decisions of those type of firms because the real discussions are in fact undertaken outside those board meetings.

According to many interviewees, governmental and family representation on boards are widespread in Saudi listed companies. Those representatives are appointed in such firms because of their large stakes. Governmental representatives are always appointed by the governmental agencies such as the Ministry of Finance. However, nine interviewees indicate that most of these representatives suffer from weaknesses in financial and business aspects of the market. R7 states:

Their role is usually to ensure boards compliance with agreed policies and regulations.

However, R10 argues:

The role of boards is not usually involved in the micro-level of the business; therefore, deep experience is not required or expected from representatives of governmental holdings on boards.

As explained in previous chapters, Jensen and Meckling, (1976) indicates that board composition reflects the extent of its abilities and efficiency. In the Saudi capital market, major shareholders are deemed to be affecting the selection process of board members despite the efforts made by the CMA to enforce laws to assure board independence (Piesse et al., 2012). Therefore, interviewees were asked about their perception of board independence.

R2 states that his company focused on the issue of board independence when they were going on IPO years ago. They replaced their relatives in the board with independent directors to be more appealing in the capital market. R15 claims that the concept of board independence is by some means controversial in the Saudi market, which confirms the findings of Ezzine (2011) who states that board independence continues to be a debatable issue.

R3 disagrees with the extent of importance that is given to the issue of independence, and says:

This issue is overrated ... boards with only independent members are not always good for the firm They lack loyalty to the firm since they are here for a specific time only ... executives are more trustworthy of protecting our interests.

R7 argues that the level of independence cannot be effective in all types of firms. He indicates:

In the case of large corporations, I think that board independence enhances its effectiveness while smaller firms gain no noticeable benefits of having a totally independent board.

Regarding the appointment process of board members, some interviewees believe, as investors and part of boards, that the power of appointment of boards is basically in the hand of dominant major shareholders especially the government and wealthy families. They consider this issue as a complicated problem which is not in the benefit of all shareholders equally. R9 said:

As long as there are major shareholders in a company then they would have the power to appoint their favourite candidates as members of the board of directors and that is the reason behind the lack of participation from minority shareholders in this process.

However, five interviewees claim that the current method of the appointment of board members in fact reflects the reality that major shareholders are more concerned and would be the most affected by board decisions due to their large stakes in the firm. Hence, they believe they have the right to be dominant, concerned, and influential on the issue of the appointment of board members.

Regarding the issue of CEO duality, some interviewees reveal that many firms, especially family-owned firms, had merged the role CEO and chairman with the exception of some firms that were controlled by the government. Following the recommendation of CEO duality mechanism in the CGC 2006, all interviewees declare that their companies have separated the two roles. In fact, this research supports this response as after examining the financial reports of listed companies for the period 2013-2017, it is found that all companies, except two, implemented this mechanism. However, the CMA annual report of 2015 revealed that this mechanism is commonly violated in the Saudi capital market. The interpretation of this contradiction can be that the CMA examined the split of the two roles in reality and not only based on published information in companies' annual reports. This is explained by the response of some interviewees who stated that family-owned companies prefer merging the two roles, so they perhaps had not split them as of 2015.

7.4.2.2 Board Size

One of the CG mechanisms discussed with interviewees was the size of board of directors. One third of interviewees encourages the presence of large boards. R9 states:

Large boards allow the company to appoint members with different specialities Having many members with different backgrounds shows me more confidence in their skills I would like members to be having backgrounds in Accounting, Finance, Business Law, Auditing and so on They would be highly effective sitting in board sub-committees.

However, eight interviewees seem unattracted to large boards. R1 highlights:

Having large boards actually causes delays in the work process It is hard for them to communicate efficiently while smaller board can easily interact and communicate with each other and speed up the process of work.

R11 also expressed his dislike of large board because of lack of control, and indicates:

I prefer to invest in corporations with smaller boards with makes it easier to me to monitor their work and can ensure the protection of my interests.

Additionally, R6 states that the aim behind having large boards is not for the sake of the business. He says:

All listed firms now follow the board size rules in the Saudi code of CG which requires the number of board members to be between three and eleven but some firms are having large board as a mean of showing off , which concerns me personally in regard of their actual motives for having this number of members on the board when there is no diversity in knowledge and experience.

7.4.2.3 Board Sub-Committees

In the Saudi CGC 2006 (see Appendix F), the only two mandatory board sub-committees are the Audit Committee and the Nomination and Remuneration Committee. Regarding this CG mechanism, all interviewees confirm the establishment of three most prevalent committees in Saudi companies namely: the Audit Committee, the Nomination and Remuneration Committee and the Executive Committee. In addition, some interviewees state that they have established other types of board sub-committee in their firms and noticed others in their investee firms such as the Investment Committee, the Internal CG Committee, the Finance Committee, and the Sharia Committee. Twelve interviewees come to an agreement on the importance of the Audit Committee among the other types of committees whereas four interviewees consider the Nomination and Remuneration Committee as important as the Audit Committee. R5 states:

In my experience, I find the Audit Committee has the most focus of most shareholders especially major shareholders Unfortunately, some members of this committee can be inexperienced and provide no assurance of the quality of audit procedures of the company.

R12 also indicates that the Audit Committee was mandatory prior to the issuance of the Saudi CGC 2006, and indicates:

We, as investors, would ensure that members of this committee would have the proper qualifications especially in Accounting and we do not tolerate incompetency in this committee because we have always been believing that this committee is one of the ways to protect our interests However, some companies might underestimate its importance.

This is in fact true as the CA 1965 required companies to establish Audit Committees. Two interviewees confirm having board committees such as Audit Committee even before the mandate of the Saudi CGC 2006. R1 states:

The main motive to establish this committee was the advice that was given by the company's founder, there was a need for social responsibility and governance within the firm.

Other reasons for establishing such committees are revealed by interviewees. R10 indicates:

The spread of board sub-committees was due to the power of board members and having the same board members in different firms has also helped spreading the gesture.

However, one interviewee claims that:

Although there was a law enforced in the mid-1990s regarding the issuance of Audit committees in listed firms, most firms overlooked such law due to the weakness of the monitoring system at the governmental level.

Furthermore, the issue of board committees and their appointment process is explained by some interviewees. R6 states:

The appointment of board members in the past was the job of the chairman or limited number of board members who are most involved with CEOs.

Additionally, R4 reveals:

My firm in fact followed internal designated procedures for the appointment of committees' members before the mandate of CG provisions.

Interestingly, R7 discusses one aspect of the appointment process, and indicates:

It is not expected of a board member to nominate himself as a committee member even if he believes he has the ability and the experience to fulfil the tasks of this job This is even unacceptable socially This job is now assigned to the remuneration and nomination committee according to the current Saudi code of CG.

7.4.3 Cumulative Voting System and Shareholder's Right

7.4.3.1 Cumulative Voting System

The growth of practices relating to major investors have provided the ability to act as good monitors within investee firms (Gillan and Starks, 2003; Ferreira and Matos, 2008). Governments and capital markets have placed pressure upon major investor aiming to enhance their CG practices (Mallin, 2016). Shleifer and Vishny (1997) states that major investors tend to require specific basic legal rights, such as voting rights, to engage with the management of their investee firms and negotiate amendments to their CG structure. Major investors are believed to make one of two decisions if they were dissatisfied with CG structure of their investee firms (Hirschman, 1970). Both decisions are acknowledged as 'Vote or Exist Concept', which means that they are granted the opportunity to exercise their voting rights to seek changes, or they may sell their shares and withdraw their investment. It is usually costly to withdraw an investment from an investee firm; therefore, major investors have a tendency to have a dialogue with their investee firms to come to terms on particular arrangement regarding CG practices (Jin, 2006; McCahery et al., 2016).

According to the US Secretary and Exchange Commission (SEC), cumulative voting is:

Cumulative voting is a type of voting process that helps strengthen the ability of minority shareholders to elect a director. This method allows

shareholders to cast all of their votes for a single nominee for the board of directors when the company has multiple openings on its board. In contrast, in "regular" or "statutory" voting, shareholders may not give more than one vote per share to any single nominee.

They further demonstrated the use of cumulative voting in comparison with the regular method:

For example, if the election is for four directors and you hold 500 shares (with one vote per share), under the regular method you could vote a maximum of 500 shares for any one candidate (giving you 2,000 votes total - 500 votes per each of the four candidates). With cumulative voting, you could choose to vote all 2,000 votes for one candidate, 1,000 each to two candidates, or otherwise divide your votes whichever way you wanted.

It is believed that cumulative voting is a useful governance mechanism especially in developing markets that are characterised with concentrated ownership (Berglof and Pajuste, 2003). Arguably, cumulative voting contributes to improvement of company performance as more outside directors are appointed due the minority representation on boards, which leads firms to be well-governed (Bhagat and Brickley, 1984). The Saudi CGC 2006 grants shareholders with various rights including the right to vote, which is deemed as an internal CG mechanism that enable shareholders to engage with their investee firms. Nevertheless, the Saudi CGC is criticised in regard of not providing incentives to shareholders to exercise their monitoring role effectively (Aljahdali, 2014).

As a part of the CG score, which is constructed by the researcher for the quantitative analysis of this research, one of the main mechanisms included is the cumulative voting policy that states all listed companies shall implement this mechanism and provide an electronic system for the process of cumulative voting. The Saudi CGC 2006 had not required listed firms to implement this mechanism but made it a voluntary one. However, a modified version of the code that was published in 2012, made it mandatory. As mentioned earlier, this mechanism allows shareholders to have one vote per share, which changes the balance of control in firms to some extent. The interviewees stand to this issue can be divided into two parts. One part of interviewees believes this approach to be beneficial in relation to the selection process of

board members because the role of the state and wealthy families (as major shareholders) in this process would diminish. In contrast, three interviewees state that governmental shareholders prefer this mechanism to be implemented. R12 says:

The CMA delayed the mandate of this mechanism comparing to most of other mechanisms in the code I have noticed pressure made on firms that are considered government-controlled to employ the cumulative voting system before it was even mandatory.

R4 expresses his view of the advantage of this mechanism, and states:

I considered it a very good tool to fairly distribute the voting rights between the different categories of shareholders especially minority shareholders ... the voting rights of minority shareholders is now stronger than ever ... they can have an impact on the process of the annual general meetings especially in the issue of selecting board members.

On the other hand, two thirds of interviewees believe that this mechanism weakens their ability to control their capitals in investee firms. R1 states:

The cumulative voting system would swap the role of appointing board members from major shareholders to all categories of shareholders ... or at least weakens our role significantly ... This is uncalled for.

R11 also criticises this mechanism, and indicates:

As a major shareholder I would be the most affected by any negative outcome of this mechanism I believe I have the right to have an influential opinion of who sits on the board.

Interviewees also expressed their resentment in regard of the chance of failing to achieve their business objectives in their investee firms. R2 argues:

Whether I am the owner of a company or even a major investor in another one, I believe that sensitive positions such as being a board member is crucial to its success Why cannot I endorse my trustworthy individuals? They are who I prefer to lead the company to achieve my business objectives.

Similar responses were presented by other interviewees who believe that applying this mechanism in investee firms could result in losing their power on boards, which could occur when new members are selected and then make attempts to steer the firm toward other objectives. Interviewees claim that this approach is inconsiderate of the interests of major shareholders. R8 states:

It is unfair to reduce our influence to this degree how can I be equal to another shareholder who holds only a thousand shares in the company?
This approach should not be mandatory at all.

Apparently, this interviewee has limited understanding of the cumulative voting system because as per the Saudi CGC 2006 (see Appendix F, Article 18) the cumulative voting system states that every share of the entity has one vote in the general assembly and cannot be reused. Hence, major shareholders sensibly still own higher number of shares compared to minority shareholders, but their influence on the selection process is somewhat compromised. R5 says:

Although this mechanisms is now mandatory by the CMA, it has not been applied by all companies in the Saudi capital market....some companies have been reluctant to implement it and expressed some kind of justifications because of the conflict of interests of their different parties.

R7 adds up to this point by highlighting the issue of fraud and says:

Some people in the market accuse us of committing fraud and resist new business laws for the sake of abnormal profits but this is untrue our interests have the priority of our focus and we would become concerned if new members are appointed in boards whom we do not trust.

These responses expose the issue of the social ties among major shareholders and their investee firms. The Saudi social environment has always been affected by the business and social ties among investors. R1 highlights:

Our business investments are mainly based on our personal relationships with investee companies They can be relatives or very close friends Changing the way of appointing board members and the voting system as whole would have a complication on the original objectives of our investment In Saudi Arabia, many people still prefer personal ties with others rather than personal qualifications.

R5 also confirms such opinion, and states:

I prefer to select someone that I personally trust but I always select the most qualified person ... we are the long-term and supportive shareholders that the company rely on.

However, the size of major ownership is the fine line between gaining and losing control of investee firms according to three interviewees. R10 indicates:

This mechanism may affect major shareholders who own only 5-10% of shares but those who own higher percentages would be the least affected The rest of votes would not have a considerable effect on the outcomes of annual general meetings.

7.4.3.2 Shareholders' Rights

This research employs mechanisms related to shareholders' rights in the quantitative examinations (Chapter Six) as a part of the CG score, therefore, interviewees were asked about their views of the current quality of practices related to their rights in the Saudi capital market. As discussed earlier, the Saudi framework of CG is established based on the Anglo-American model which focuses on shareholders' interests and rights (Alshehri and Solomon, 2012; Piesse et al., 2012). Piesse et al. (2012) argue that the CG framework in the Saudi capital market is based on the Anglo-American model that focuses on shareholders' interests, which explains the reason that interviewees lean toward the benefit of CG regulations in relation to the protection of their interests.

Interviewees were asked about their perception of the annual general assemblies and information asymmetry. Several responses revolve around the same point which is the right of dividends distribution. R7, who is also a board member of a listed company, says:

General assemblies unfortunately are not utilised as expected. Most of attendants focus on issues related to dividends mainly.... Shareholders tend to care about their earnings from their investments.

Although this point may be true, R11 argues:

To be honest, most of shareholders especially the minority feel their presence have no impact on these meetings, so they concentrate on dividends.... Their carelessness of other issues is fairly justified since their stakes are not as large as ours.

This is supported by Piesse et al. (2012) which finds that the presence of major shareholders in Saudi Arabia steers minority shareholders away from being active in the market. However, R9 reveals that the failure of shareholders activism in Saudi Arabia is caused by the method that those meetings are held, and indicates:

Being a frequent attendant in many assemblies, I notice that some firms do not manage their meetings properly Some of them try to follow fixed agenda without granting shareholders the opportunity to debate or discuss matters that are important to them ... this culture leads many shareholders to being passive in meetings.

In contrast, R6 who is also an executive, states that shareholders are regularly motivated by the firm to be active and contribute to general assemblies. He says:

We always support their presence and contribution to general assemblies However, all they can focus on is financial matters related to their profits and dividends.... Also, some minority shareholders think that being active is not worth it since they own a small number of shares and can be costly to attend such meetings in another province of the kingdom.

Overall, most interviewees believe that the magnitude of ownership determines the attitude of shareholders in general assemblies. R4 highlights:

Many major shareholders attend such meetings and concentrate on financial and non-financial issues because they think of themselves as long-run investors ... Therefore, their investments need to be monitored frequently with the management.

Regarding the quality of published information, some interviewees believe that there has been a noticeable improvement in the quality of financial statements contents and other firm resources of information. R4 states:

The technology has helped a lot in keeping us up-to-date with many aspects of our investee firms Years ago the CMA launched its official website (Tadawul) which is now one of the main and useful resources of information about listed firms Firms are obligated to report to this website with every formal aspect of its operations and meetings.

R10 also indicates:

Since the CMA made many CG practices mandatory, we started depending on the information published by firms on their website or on the capital market website (Tadawul) as they became more comprehensive, which decreased the need to follow up with our investee firms in some aspects However, we still use our methods in communication with them and obtain the information we need.

7.5 The Role of Major Shareholders in Saudi Arabia

In this section, interviewees were asked about their knowledge of the presence of different types of major shareholders and their role as major investors in the Saudi capital market. Their responses differ somehow in regard of their knowledge about their impact on the market and the CG regulations in Saudi Arabia. Only five interviewees recognise different types of major shareholders in the Saudi market while the majority acknowledge only governmental institutions and/or family-owned companies as major shareholders. For instance, R15 claims that:

The government major ownership in the Saudi market differentiates it from markets in many other countries.

R13 says that:

The government has been the dominant major shareholder type in the history of the capital market They used to own a number of companies in the market prior to their privatisation... but after the privatisation the government kept substantial proportions of their shares in those companies such as SABIC (a major petrochemical company) and the Saudi Electricity Company.

However, the first response is inaccurate because some Asian markets have this characteristic, but this lack of knowledge can be explained by the fact that the Saudi capital market and its CG regulations has been influenced by the systems in the US and UK as mentioned earlier. Therefore, investors are expected to lean toward such business culture and exposure. Additionally, the second interviewee ignores the fact that wealthy families own a relatively large stakes in a lot of listed companies as observed by this research and other work such as Al-Tonsi (2003) which shows that 75% of listed companies in the Saudi capital market were owned by wealthy families with the exception of the services sector which were mainly owned by governmental institutions. R7 indicates:

The two most dominant types of major shareholders in the market are the government and family-owned companies however, family-owned companies do not invest in companies which they have no ties with whether socially or financially.

The five interviewees, who recognise different categories of major shareholders, expressed their knowledge of the existence of such categories such as foreign investors, banks, wealthy individuals, major companies, and royal investors. R4 states:

The Saudi capital market is now expanding and attracting many foreign investors especially international institutions the recent IPO of ARAMCO (the Saudi oil company) revealed the participation of many foreign investors from China, Japan and Europe.

R1 also says:

From my experience I know there are different types of major shareholders in the capital market I have dealt with large corporations as major investors as well as other types such as wealthy individuals and banks.

In addition, these interviewees indicate that the CMA does not disclose periodic reports about this type of information, and it disregards different categories and interests of major shareholders. In fact, Tadawul website disclose major shareholders in all listed companies on a daily basis, however, they do not provide monthly nor annual reports of information related to such shareholders, which makes it difficult to track the data that covers a long period. Nevertheless, it is found that some listed companies do publish information about their major shareholders in their annual financial statements.

Regarding the interests of major shareholders, some interviewees argue that the CMA is unaware of their interests in the capital market. Most of these interviewees are unable to express justifications of this issue, but R9 highlights:

Major shareholders do not anticipate having an impact on the market, therefore, recognizing our interests is not an issue to the regulators or even listed companies.

This comment confirms the work reported by Alakkas (2016) which shows that regulators have no desire in identifying the interests of different types of major shareholders because the capital market regulations are made for every investor in the market with disregard of their type or size of portfolios.

In addition, two interviewees consider it crucial to comprehend the different categories of major shareholders and their objectives related to the market in order to understand their role and influence. R10 suggests:

It is important to know such information to evaluate a potential investee company and the level of independence of its board.

R4 indicates that:

Such information can promote the level of firms' transparency.

One interviewee, however, states that many companies do not disclose information about major shareholders because they are not considered important unless they are major institutions or investors that have a network of relationships with the firm executives or even the market in general. In contrast, R3 states:

Even large corporations can be disregarded by investee companies unless they have a representative on their boards As long as they are represented in board meetings then we can say they are able to have an influence on the company some companies prefer to disclose such information as an attractive aspect for potential investors to show that they are desirable by major investors but unfortunately not many follow this approach.

Moreover, interviewees were asked about their views on the extent of power that some major shareholder, whom they believe are powerful, may have. Many interviewees consider that

family-owned companies are the most type of major shareholders that has a powerful influence on firms because when they run their firms, they seek the continuity of their profits and name, hence, they always pursue the protection of their large stakes. R12 says:

Most, if not all, family-owned companies concentrate on their continuity in the market Since most of them have a long history in the market, they would avoid any investments choices that may threaten their reputation.

According to some interviewees, they state that although wealthy families sometimes own less than 50% of an investee company shares, but they still seek the control of its operations and future plans. R5 states:

Wealthy families do not act as investors only but they insist on having the power to manage and control the way their investee companies are operating it is like their own property even though they own just a proportion of it.

Besides, some interviewees believe the government, as a major shareholder, has an influential and dominant role in investee companies. R11 states:

Their ownership motivates companies to operate better.

Some interviewees claim that the government presence on board of directors has additional impact on other types of shareholder. R7 says:

The presence of the government ownership is attractive to many potential investors or shareholders especially minority shareholders They trust firms that the government invests in.

Nevertheless, three interviewees have a different opinion regarding this point and report that the government investee companies are unattractive to major shareholders. R1 highlights:

The government ownership is not always attractive to us They tend to control their investee companies and influence its operations and objectives which can cause a conflict with our own objectives and interests.

This view has been indicated Al-Janadi et al. (2016) who found that decision-making process of investors is negatively affected by high governmental ownership in firms. R6 confirms this point of view by saying:

It is hard to find both governmental institutions and wealthy families controlling the same company Their business objectives are never the same ... Also, some large corporations tend to avoid investing in a company that is government-controlled.

R5 explains one of the reasons for this negative aspect of the government ownership in investee companies by stating:

The government, as a major shareholder, neglects the importance of selecting competent and suitable representatives or directorsWe notice that in most cases their representatives do not have the capability and experience needed for the business Some of them have no proper educational backgrounds.

Furthermore, interviewees have been asked about the impact that major shareholders could have on CG regulations. Most of them agreed that they noticed no impact of major investors whatsoever over the development of CG regulations. R11 argues:

CG regulations are prepared and designed solely by governmental institutions such as the CMA ... We do not have a role in this matter.

R8 states:

It would take an enormous power to change CG regulations on the governmental level, which none of the current major shareholders in the market has so far.

7.6 Impact of Corporate Governance on Investment Decisions

In general, interviewees responses have demonstrated no substantial and direct linkage between their portfolios and the CG structure in potential investee firms. Many interviewees present other factors affecting their investment decisions such as: the market position, firms' financial data, the risk attached to firms' operations, and firms' assets. There is a general view amongst

interviewees that CG is an intangible aspect of firms and cannot be valued financially. R14 reveals:

CG is still not a fundamental issue to investors in the Saudi capital market despite the efforts made by the CMA to promote its importance and impact over companies Not every aspect of CG can be evaluated financially, which is the core concern of many investors.

However, two interviewees express a slightly different view of this point as R10 says:

I believe CG is important, but some investors have limited knowledge about this issue We, as investors, are supposed to educate ourselves more to grasp the necessity of CG practices.

R6 mentions that after the capital market collapse of 2006, we became more cautious with CG issues in firms that we plan to invest in. He says:

Even though we had insufficient background of CG prior to the collapse of 2006, but after reading numbers of articles in the newspaper and watching many programs on the television throughout the subsequent years, we became more aware of the fact that CG is a serious issue in our market The CMA work in the years following the crash proved the importance of this issue.

This response confirms what R9 reveals about the level of exposure to CG among major investors, and indicates:

I have never encountered or heard about a major investor that investigates CG aspects of potential investee companies in the Saudi capital market Perhaps some investors may talk about CG issues on the press but in reality they ignore it.

In addition, R11 explains one point behind the disregard of CG issues and says:

If we examine the CG regulations issued by the CMA, we can find that some mechanisms were actually important to some major shareholders in the Saudi capital market such as the aspects related to board composition and Audit Committee Many investors had no idea that these

mechanisms are a part of CG Some of us actually investigate these aspects of investee firms but not for the same purpose.

Contrary to these responses, four other interviewees indicate that some aspects of CG such as firm structure, board composition, and audit committee are considered and evaluated as a part of the evaluation process undertaken by their investment teams. R10 states:

The qualifications and experience of members of board of directors are a crucial issue to us even if the company is an appealing choice of investmentif we notice a flaw that we believe is appalling we may use our power to change things but in a diplomatic and friendly way.

R7 also confirms the importance of boards quality of potential investee firms by stating:

When evaluate a potential company that we plan to invest in, we believe their financial success depends mainly on the competency of its management, therefore, we investigate its board composition and ensure their capability of success and protecting our investment.

Moreover, two interviewees link the CG practices to the reputation of the firm in the market which makes the issue of CG involved in their investment decision. R5 reveals:

Currently, the reputation of listed firms are somehow affected by its quality of CG practice Board composition and quality of their disclosures have become an attraction tool which affects our investment decision ... I believe companies with good CG practices in place is attracting major shareholders because it provides a confidence in their ability to run the business as it should be.

Furthermore, some interviewees express their consideration of the competency of the Audit Committee in companies. R4 highlights:

All my investee firms have Audit Committees that consist of highly qualified and experienced members The quarterly and annual financial statements must be produced properly, and all numbers must reflect our position because at the end of each year we need an Audit report from the external Auditor to confirm the reasonable financial position of my investee company, which is very important to us.

Furthermore, two interviewees reveal that they would ensure that investee firms are not being penalised by the CMA due to non-compliance with the market regulations including CG ones. R13 argues:

Being a penalised company would trigger an alarm in regard of the appropriateness of control and monitoring of the top management of this company I do not tolerate such behaviour with no reasonable justification.

R10 also noted that he views CG issues of an investee firm from the risk aspect of it, however, he states:

Although this is an issue to look at but would not have a significant impact on the investment decision if all other financial and future-wise aspects of the company are promising.

Finally, one interviewee indicates that the issue of CG among investors with large portfolios in the Saudi capital market is rarely relevant except of governmental institutions. R9 explains:

For instance, if a government institution is willing to purchase large stakes in a firm that has improper governance practices, it would push improvements and enforce CG mechanisms after settling the deal They are powerful.

Nonetheless, this last response does not reflect the reality that a few listed companies, that the government has invested in, are struggling in the market on both the financial and managerial levels.

7.7 Summary of Main Findings

This section provides a summary of the findings of semi-structure interviews that were presented in this chapter. Questions were constructed based on five main themes: the perception of CG, the importance and compliance of CG, the perception of CG regulations, the role of major shareholders, and finally the impact of CG on major shareholders investment decisions. Some of the findings were in consistent with prior studies and some results presented new views of the issues in question.

Regarding the perception of CG, in comparison with prior research such as Falgi (2009), major shareholders seem to be more educated in the issue of CG in the Saudi context. Many interviewees have provided distinct definitions of CG and emphasised on linking it to the management and control of firms. It is also found that some major shareholders are influenced by the CG definition of Cadbury (1992) which is justified since the Saudi CG practices were influenced by the UK CG regulations. Major shareholders also emphasised on the importance of CG regulations nowadays compared to weak awareness shown in the market in prior studies. In general, interviewees can be split into two groups in relation to the perception of CG. The first has a narrow view of CG that focuses on the agent-principal relationship, while the second group has a more comprehensive view of CG that include issues such as interests of stakeholders and accountability. However, most interviewees link CG to risk issues which is expected according to Schneider and Scherer (2015).

Different responses have been provided by major shareholders regarding CG mechanisms in the Saudi capital market. In regard of board of directors, most interviewees supported the current composition of boards and the level of independence whereas a third of interviewees opposed the total independence of boards and promote the presence of executives on board as they are expected to outperform independent members.

Many interviewees expressed their observation of the dominance of governmental institutions and family-owned firms in the Saudi capital market. Several of them question the independence of their boards. They also state that representatives of such major shareholders are usually incompetent and lack experience. In addition, two thirds of interviewees opposed large boards. They believe that having large board is not practical for the business. In contrast, some interviewees support large boards which enable companies to appoint experienced and qualified members of different backgrounds. The majority of interviewees state that the presence of board sub-committee is beneficial to the business. Members of such committees especially the Audit Committee have a vital role in their investee companies.

Regarding the cumulative voting system that is imposed upon listed companies. Interviewees' responses can be divided into also two groups. One group support this system and believe in its benefit to the business and state that it would limit the control of the state and wealthy families in their investee firms. However, two thirds of interviewees express their resentment toward the implementation of such system. They indicate that their lawful rights, including their control role, would be weakened. They believe they have the right to control their investee

firms as long as they own large proportions of their shares. However, three interviewees highlights that this is inaccurate since investors who own large stakes that exceed 10% of the total shares would still be able to play a controlling role.

Interviewees expressed their views toward their rights as shareholders. Several responses focused on their rights in relation to financial matters such as dividends. However, some of them raised their concern of the manner that general assemblies are held. They believe that some companies still view such meetings as just a rule to follow with disregarding the needs of many shareholders including small ones. The majority of interviewees indicated that the size of ownership determines the role played in general assemblies. In the issue of information published by firms, some interviewees highlight they have noticed an improved quality of information in firms' financial reports compared to the last decade.

In regard of the types and the role of major shareholder in the Saudi capital market, only five interviewees recognise distinct types of major shareholders in the market. Most interviewees relate major shareholders to the state and wealthy families only as they viewed to be having an influential role in the market. They expect the CMA to make more efforts in disclosing information about the types and interests of major shareholders. In general, the majority believe that they have no role in affecting CG practices in the Saudi capital market.

Finally, interviewees have expressed no substantial linkage between their investment decisions and CG practices in potential investee firms because CG is viewed as intangible aspect of firms that cannot be examined financially. However, few interviewees their concerns of CG quality in investee firms. They would focus on board composition, independence, and Audit committees of such firms when they evaluate their investment decisions.

7.8 Summary of The Qualitative Assessment results of The Corporate Governance Preference of Major Shareholders

7.8.1 Perception of Corporate Governance

7.8.1.1 Wealthy Families

Wealthy families as major shareholders view CG as a set of rules that manage the relationship between agents and principals, which is the same view as expressed by few institutional investors.

7.8.1.2 Governmental Institutions

This type of major shareholders views CG as a collection of laws and practices that aim to protect the wealth and rights of all stakeholders including lenders and suppliers and other parties rather than shareholders only. They elaborate in that such rules and practices are essential for firms to avoid encountering risky challenges that may lead to their collapse.

7.8.1.3 Institutional Investors

This type of major shareholders has also pinpointed the linkage between CG and the protection of stakeholders' rights within the market. They argue that CG is supposed to provide stakeholders with tools that assist in guarding their interests. Additionally, this type describes CG as a comprehensive framework that boards need to protect the interests of different stakeholders. However, few major shareholders of this type linked CG to the relationship between agents and principals. They indicate the CG is a tool used to prevent conflicts between the management and shareholders. They also argue that CG is an approach to manage and control their businesses aiming to protect shareholders' interests and prevent the collapse of firms.

7.8.2 The Importance and Compliance of Corporate Governance

7.8.2.1 Wealthy Families

This type of investors noticed improvements in their control and monitoring practices over the year which increased the importance of CG in their view. They argue that the awareness of the outcomes of implementing good CG practices is beneficial for controlling firms and having

better disclosures. However, one major investor of this type indicates that the compliance of CG practices had not been that simple because the first published code was not fully adaptable in the Saudi capital market which is influenced by its cultural and social characteristics.

7.8.2.2 Governmental Institutions

This type believes that CG laws have improved the reporting and transparency of boards when comparing the content of annual reports before and after the market collapse in 2006. Boards have become more aware of their duties and responsibilities, which assures the importance of CG.

7.8.2.3 Institutional Investors

The importance of CG has risen substantially after the collapse of the Saudi capital market. This type believes that the importance stems from the fact that disclosure quality of listed firms have developed comprehensively. They indicate that annual reports used to be poorly prepared prior to the enforcement of CG laws in the kingdom. The CMA reviewed the published codes globally and implemented the UK's comply or explain approach. Two major shareholders of this types indicate that this approach was ineffective within the Saudi capital market because of the social and cultural norms that make investors unwilling to follow voluntary practices, which delayed the implementation of many provisions for few years. However, they indicate that penalties that were imposed on firms for not following specific provisions had helped in speeding up the process of compliance.

7.8.3 The Perception of Corporate Governance Mechanisms

7.8.3.1 Board composition and independence

7.8.3.1.1 Wealthy Families

Wealthy families indicate that the appointment of executives in boards is essential for the benefit of the business. They believe that all board members, whether executives or NEDs, are equally important to the firm and both have the same access to needed information. However, they indicate that CEOs are more competent in managing the business than NEDs. In their opinion, the issue of board independence is overrated as boards that are exclusively constructed by independent members are not always effective for the business's sake.

7.8.3.1.2 *Governmental Institutions*

Major investors of this type believe that the current practices enforced by the CMA, in regard to boards composition and independence, are intended to protect the interests of the owners as well as other parties.

7.8.3.1.3 *Institutional Investors*

Regarding board composition and independence, this type states that the independence of boards is important. Three major investors oppose the appointment of executives because of their direct access to information that may influence board decisions. Nevertheless, few investors argue that the level of board independence is linked to the type and size of the firm.

8.3.3.2 *Board Size*

8.3.3.2.1 *Wealthy Families*

Wealthy families tend to prefer smaller boards because of the slowness in work processes caused by having large boards. The interaction and communication between members of small boards are more effective and beneficial for the business.

8.3.3.2.2 *Governmental Institutions*

This type of major investors states that the Saudi CGC grants companies the choice to appoint between 3 to 12 members in their boards. This is believed to be providing the opportunity to select the board size that is more suitable to each listed company based on their different needs.

8.3.3.2.3 *Institutional Investors*

There are mixed responses of institutional investors in regard of board size. One group expressed their dislike of large boards because of the difficulty of monitoring their activities. The other group, however, indicated that large boards have the advantage of appointing members with many backgrounds and experience which would effectively improve the execution of business operations.

7.8.4 Cumulative Voting System

7.8.4.1 Wealthy Families

The cumulative voting system is highly unfavoured by wealthy families. It is believed that implementing such mechanisms would weaken the impact of major shareholders on investee firms, who are presumably the most affected by board decisions due to their high stakes. Additionally, they argue that major investors inherit the right to endorse trustworthy individuals to be in boards in order to achieve their business objectives.

7.8.4.2 Governmental Institutions

The cumulative voting system is considered by this type of investors as an effective tool to fairly distribute votes between majority and minority shareholders. The role and impact of minority shareholders have become stronger in general assemblies.

7.8.4.3 Institutional Investors

Most of institutional investors dislike the cumulative voting system. They indicate that major investors should have a more powerful influence over their investee firms because they are the most affected by any negative outcome of implementing such mechanism. They believe that many listed companies have not implemented this mechanism due to conflict of interests between stakeholders.

7.8.5 Shareholders' Rights

7.8.5.1 Wealthy Families

Wealthy families share similar standpoints with some institutional investors in regard to shareholders' rights. They believe that the reason for the fact that some general assemblies are managed by fixed agendas is that many shareholders concentrate on dividends only. Additionally, they believe that major shareholders actively interact in general assemblies.

7.8.5.2 Governmental Institutions

Governmental shareholders indicate that the size of ownership determines the attitude of shareholders in general assemblies. Major shareholders tend to engage during these meetings in both financial and non-financial issues as a way of controlling and monitoring the individuals who are responsible for the protection of their capitals.

7.8.5.3 Institutional Investors

Institutional shareholders state that general assemblies are not ideally utilised. Most shareholders focus on dividends distribution rather than other vital issues related to firms' operations. The reason is believed to be that shareholders feel their presence has no significant impact on the outcomes of general assemblies. Some institutional investors argue that the weakness of shareholders activism within the Saudi market is due to the way that such meetings are held. The inappropriateness of managing general assemblies has led shareholders to be passive during such meetings.

7.8.6 The Presence and Role of Major Shareholders

7.8.6.1 Wealthy Families

Some family-owned firms are aware of different types of major shareholders that exist in the Saudi capital market such as governmental institutions, wealthy individuals, and banks. They believe that the government ownership in listed companies is not always attractive to other major investors because of a conflict of interests that may occur due the powerful impact of governmental institutions over their investee firms.

7.8.6.2 Governmental Institutions

The governmental shareholders recognise various types of major shareholders namely, banks, foreign investors, wealthy businessmen and royal investors. They suggest that regulators should take into consideration the interests of different types of major shareholders as such information could promote firms' transparency level.

7.8.6.3 Institutional Investors

Some institutional investors acknowledge only governmental institutions as major shareholders in the Saudi capital market. Other institutional investors recognise the government and wealthy families as the dominant types of major investors in the market. They expressed their resentment of the CMA disregard of their interests in the market which led their role to be passive in the market since their interests are not recognised by regulators. Furthermore, this type of major shareholders mostly agree that the most powerful type of major investors is family-owned companies because of their pursuing of continuity. Few major investors believe that the ownership of governmental institutions motivates companies to operate better which

makes the government an influential player in the market. Other investors indicated that some institutional investors sometimes avoid investing in government-controlled firms.

7.8.7 Impact of Corporate Governance on Investment Decisions

7.8.7.1 Wealthy Families

Family-owned firms state that CG is not linked to their investment decisions. They indicate that they have other matters to consider when evaluating investment options, particularly financial and prospective matters.

7.8.7.2 Governmental Institutions

Governmental institutions state that some aspects of CG issues such as provisions of the Audit committee are highly considered.

7.8.7.3 Institutional Investors

Mixed responses have been gained from this type of major shareholders. In general, CG is not directly linked to investment decisions of institutional investors. Some of them suggests that CG is not a fundamental issue for investors to evaluate while others believe that the collapse of the Saudi capital market in 2006 have made investors more cautious in regard to CG issues within the market.

7.9 Integration Between Findings of Quantitative and Qualitative Assessments

7.9.1 Introduction

Chapter Six and this Chapter presented the findings of the quantitative and qualitative assessments of this research, respectively. Thus, the main objective of this chapter is to integrate the quantitative and qualitative findings of this thesis to develop a coherent explanation of the relationship between CG and major shareholdings in Saudi Arabia. As demonstrated in Chapter One and Five, this thesis uses primary data to support secondary data and to cover aspects of CG that cannot be covered by secondary data (see Figure 5.1 in Chapter Five). Using mixed-methods approach is useful for explaining findings of both primary and secondary data (Creswell and Clark, 2011; Boyd et al., 2012). This approach is deemed effective in terms of developing a deep comprehension of CG behaviour (McNulty et al., 2013;

Zattoni et al., 2013). Therefore, this thesis utilises the Explanatory Sequential Design (two sequential stages) presented by Creswell and Clark (2011). The Explanatory Sequential Design is based on two different collaboration stages. The researcher collects secondary data to perform quantitative assessment and then explores views of participants through interviews. This is expected to portray a comprehensive picture of the quantitative findings that examine the presence and nature of the impact of CG on investment decisions of major shareholders.

The following sections present two main objectives of this thesis that have been examined by both qualitative and quantitative methods (i) the perceived impact of CG on major shareholders investment decisions and (ii) CG preferences of major shareholders in Saudi Arabia.

7.9.2 The Impact of CG on Investment Decisions of Major Shareholders

The primary objective of this thesis was to investigate whether the CG structure of potential investee firms affects the shares selection of major shareholders in the Saudi capital market. To achieve such objective, this thesis employs qualitative and quantitative methods to portray the perceived impact. This section compares the findings of quantitative assessment and qualitative assessment. To perform a quantitative assessment, this research employed multiple regression analysis by using collected secondary data from three main sources namely: Bloomberg Database, DataStream and annual reports of listed companies. In order to support the findings of the quantitative analysis, primary data were collected by conducting semi-structured interviews with fifteen major shareholders categorised by this thesis as wealthy families, governmental institutions, insiders, wealthy individuals, royal investors, financial firms, funds and insurance firms, and other institutional investors.

The CG mechanisms that have been examined by both quantitative and qualitative analysis are divided into two sets (i) CG score that consists of mechanisms related to shareholders' rights (voting rights and general assembly regulations) and (ii) board quality that consists of board characteristics namely: size, independence, and NEDs.

7.9.2.1 CG Score

As is evident from Chapter Six, the regression results showed a significant and negative relationship between CG score and aggregate major shareholdings (Model 1, Table 6.4). This indicates that major shareholders in the Saudi capital market do not prefer to invest in listed firms that implement CG mechanisms that relate to voting rights and general assemblies. This is supported by the results of the qualitative assessment which showed that most interviewees, especially wealthy families, oppose such mechanisms. It is claimed that these mechanisms weaken the ability of major investors to monitor and control their capitals in investee firms, particularly in the appointment of board members (R1). Additionally, the consequences of implementing voting rights mechanisms are expected to mostly affect major shareholder due to their large stakes (R11). The ability to appoint trustworthy directors is seen vital to major shareholder, and this ability can be diminished by implementing such mechanisms (R2). Losing control power on boards, which may steer the board toward different business objectives, is the main concern regarding the CG score here (R8).

Due to the controversial issue of family ownership in the Saudi literature discussed in chapters three and five, this research divided the total sample into two groups: (i) wealthy families shareholdings and (ii) shareholdings of the rest of major shareholders categories. The regression results showed a positive relationship between CG score and major shareholders except of wealthy families shareholdings, which remained to be significantly and negatively affect by CG score. This indicates that wealthy families are not in favour of shareholders' rights set out by the CGC 2006, while the rest of sample prefer to invest in firms that implement such mechanisms included in the score. The significant and negative relationship with CG score has been disclosed by two interviewees of the category of wealthy families (R1 and R2) who revealed that applying such mechanisms would have implications on their original objectives of investment. They indicate that their investments are mainly based on social ties and the current voting rights would limit their influence on boards. R2 claims that the process of board members appointment is crucial to their success and they would be majorly affected if their appointees are not selected as board members, which may drive the business toward different goals.

On the other hand, the regression results of Model 2 (Table 6.4) showed a positive relationship between CG score and pooled major shareholdings of the rest of categories, but insignificant.

This provides an evidence that the aggregate major shareholdings of governmental institutions, insiders, financial firms, fund and insurance firms, royal investors, wealthy individuals and other institutional investors, are in favour of firms that follow the regulations related to shareholders rights within the Saudi capital market, but they are not significantly impacted by the CGSCORE. The findings of the qualitative assessment revealed some responses that is consistent with the regression result. Some interviewees expressed their satisfaction of the current shareholders' rights compared to previous years as the boards now encourage investors to be active and present in general assemblies (R6). Additionally, the quality of information has improved substantially especially in matters concerning contents of financial statements (R4) and investors now can fairly rely on published information (R10).

Furthermore, the same regression model used for the aggregate major shareholdings has been re-estimated for each category of major shareholders to examine the impact of CG score on each category. The regression analysis provided mixed results. It is evident that there is a positive relationship between CG score and wealthy investors, royal investors, and other institutional investors, however, the relationship is not significant except for individual investors. This is supported by the responses of two individual investors (R8 and R9) who expressed their preference for implemented CG regulations in potential investee firms. However, the qualitative results showed that their preferences vary among mechanisms of shareholders' rights. For instance, R9 criticised the way that some firms manage their general assemblies as they stick to fixed agendas and not granting shareholders the opportunity to participate properly which is a part of the business culture in Saudi Arabia.

In contrast, the regression results revealed an insignificant and negative relationship between governmental institutions, insiders, financial firms and fund and insurance companies. Due to the insignificant impact, it fails to provide an evidence to support the empirical findings of Giannetti and Simonov (2006) which revealed that managers and directors do not avoid investing in poorly-governed firms where the opportunity of private benefit by controlling shareholders is higher. In addition, it is argued that managerial shareholders tend to gain access to detailed information which assist them in preventing and consequences of having a poor CG structure. However, this result is consistent with the findings of Hawas and Tse (2016) which found that managerial shareholdings are negatively related to CG score, but not statistically significant. In the same vein, R11 stated that regulations are not that beneficial to shareholders since their interests in general meetings are related to dividends issue only. This negative relationship can also be linked to the views stated by R7 and R11 who focused on the voting

rights system and its implication on their control and power over boards. However, R4 expressed his support for the current mechanisms of shareholders' rights as many major investors are active in general assemblies and their financial and non-financial interests are taken into consideration by boards, which is inconsistent with results of the regression analysis of governmental holdings.

7.9.2.2 Board Quality

Prior literature indicated that board quality is positively associated with firm value (Kang, 2013). Higher board quality increases the possibility of good performance and higher firm value which assists investors to make informed investment decisions (Bergh and Gibbons, 2011; Chiang and Chia, 2005). Therefore, to examine the relationship between board quality (i.e. size, independence, NEDs, meetings, and royal members) and major shareholdings, this research used the same multiple regression model. The results provided a clear view about which board characteristics affects aggregate major shareholdings. However, the results do not suggest the impact of board quality on major shareholders is a simple one.

7.9.2.2.1 Board Size

Regarding board size, the regression findings proves that aggregate major shareholdings in the Saudi capital market are statistically significant and negatively related to large boards. This is consistent with the findings of qualitative assessment as eight out of fifteen interviewees expressed their dislike of large boards. R1 argues that large boards do not function properly usually cause delays in work processes. The interaction between members of small board is smoother and more efficient. Additionally, monitoring role of major investors becomes easier when their investee firms have small boards (R11). Sometimes, the motive behind having large boards is to a media propaganda as a way of showing off according to R6. He continued explaining such negative aspects by stating his observation of large board operating within the Saudi capital market with no diversity in knowledge. On the other hand, few interviewees have revealed their preferences of large boards as they are expected to consist of more

knowledgeable and competent members that are specialised in different backgrounds such as Accounting, Finance, Business Law and Auditing (R9).

The regression analysis that is undertaken for each category of major shareholders shows that the coefficient on board size is statistically significant and negatively related to wealthy families, financial firms, insurance firms, royal investors, and other institutional investors. Interviewees from categories such as wealthy families, financial firms, and insurance firms (R1, R10 and R11) stated similar viewpoints of large firms. They revealed that large board are inefficient in terms of interaction and speeding up the business process. The rest of major shareholders categories (i.e. governmental institutions, individual investors, and insiders) have shown an insignificant relationship to board size in investee firms despite the fact that R9 revealed his preference of large boards to elevate his confidence in the ability of board to properly protect his interests.

7.9.2.2.2 Board Composition

In relation to board independence, prior literature (e.g., Chung and Zhang, 2011; Khurshed et al., 2011; McCahery et al., 2010; Hawas and Tse, 2016) have revealed that board independence and composition is an important issue to investors. However, the quantitative assessment of this research found a negative but insignificant relationship between aggregate major shareholdings and board independence. This indicates that the higher the number of independent directors in a firm board, the higher the likelihood that a major investor would avoid investing in such firm. Nevertheless, the results show that the independence coefficient is statistically significant and negatively related to wealthy families shareholdings. This is explained by responses of some interviewees in this research (R3 and R1). They stated that the issue of board independence is overrated as sometimes having too many independent directors in boards is not beneficial to the firm. Loyalty is a crucial issue to the business which can be weak in the case of total independence of boards (R3).

On the other hand, the regression results of different categories of major shareholders have indicated a significant positive relationship between board independence and only major shareholdings of insiders. One explanation is provided by R7 who argues that board independence in large corporations is effective while smaller firms gain no noticeable benefits of a totally independent board. The regression results of the rest of major shareholders

categories namely governmental, financial firms, fund and insurance firms, royal investors, wealthy individuals, and other institutional investors have shown no significant relationship between their holdings and board independence.

In relation to board NEDs, the regression analysis has indicated that the coefficient of aggregate major shareholdings is significant and positively related to the presence of NEDs which provides an empirical support for the findings of Chung and Zhang (2011) which indicated that board composition is one of the CG elements that attracts institutional investors. Additionally, Khurshed et al. (2011) showed a significant positive association between institutional shareholdings and board composition in the UK. Moreover, Useem et al. (1993) revealed that board composition is an influential aspect on institutional shareholders in the US. It is argued by some interviewees that such composition is already implemented years before the introduction of the CGC 2006 as a part of the business culture in Saudi Arabia (R10). Three interviewees in fact oppose the appointment of executives on boards because of the issue of information asymmetry. They argue that the presence of more executive directors in board enables them to gain the privilege of accessing detailed information of the business which can affect board decisions. However, R3 disagree with such a statement and affirms that all board executive and non-executive members have equal access to information withing the firm.

In contrast, regression results of major shareholdings of wealthy families, insurance firms and royal investors have revealed a significant negative relationship with NEDs. This provides an evidence that such major shareholders avoid investing in companies with higher number of NEDs. This is also supported by the responses of R1 and R2. They claim that CEOs are more competent and knowledgeable of the business compared to other directors. Founders and owners have more confidence in CEOs in achieving their objective and protecting their interests. R2 stated that executives are not appointed in boards unless they can be reliable and able to perform their duties efficiently. However, R10 explains that the role of board members is not usually involved in the micro-level of the business, therefore, deep experience is not expected from board members.

Given the above, it seems that wealthy families are the only category of major shareholders that consistently have shown significant and negative linkage to both CG score provisions and board quality provisions. Interestingly, the results of the qualitative assessment have revealed a clear evidence and support to the results of the regression analysis. The findings of the quantitative and qualitative do not provide empirical support of the findings of prior studies

which revealed that CG is important to investors such as Ferreira and Matosm (2008), Giannetti and Simonov (2006), Khurshed et al. (2011), and Hawas and Tse (2016). Although agency theory suggests that investors are motivated to invest in firms that are characterised with good CG structure, but it seems this is not the case for major investors in Saudi Arabia.

In the contrary, the regression results of aggregate major shareholders (except of wealthy families) have presented mixed results. Such results are supported by prior studies while others are unlike the findings of prior studies. Table 8.1 presents the main significant findings of the integration between the quantitative and qualitative assessments.

7.10 Conclusion

This chapter provided the findings of semi-structure interviews that were conducted with fifteen major shareholders in the Saudi capital market. There are five broad topics discussed during interviews namely, the perception of CG, the importance and compliance of CG, the perception of CG regulations, the role of major shareholders, and finally the impact of CG on major shareholders investment decisions. An integration of findings of both quantitative and qualitative examinations were demonstrated that revealed some consistent results as well as distinct results with explanations provided by interviewees.

Chapter 8. Conclusion

8.1 Introduction

The primary aim of this thesis is to explore the evolution of Corporate Governance (CG) in Saudi Arabia and examine the impact of CG structure in potential investee firms on shares selection of total major shareholders within the Saudi capital market as well as the CG preferences of their different categories. As discussed in Chapter One and Five, this thesis employs a mixed-method research design to achieve its objectives. Both quantitative and qualitative assessments have been performed to gain insightful knowledge of the perceived impact that CG has on potential investments, particularly major shareholders' investments (McCahery et al., 2010; Chung and Zhang, 2011; Khurshed et al., 2011; Bushee et al., 2013; Hawas and Tse, 2016). The aim of this research is to answer six question regarding the issues being examined:

- RQ1.** What is the extent of CG evolution in Saudi Arabia?
- RQ2.** What are the views of major shareholders in regard to the perception, importance, and compliance of CG?
- RQ3.** What are the views of major shareholders to different CG mechanisms within the Saudi capital market?
- RQ4.** What are the views of major shareholders in regard to their role in the Saudi capital market?
- RQ5.** What are the views of major shareholders in regard of the impact of CG practices in potential investee companies on their investment decisions?
- RQ6.** What CG mechanisms do affect shares selection of major shareholders?
- RQ7.** What are the CG preferences of the different categories of major shareholders?

To answer the first research question, the research presented a discussion of the history of CG regulations within the kingdom and demonstrated a review of the two Saudi CG codes of 2006 (CGC 2006) and 2017 (CGC 2017). In relation to questions two to five, semi-structured interviews were conducted with fifteen major shareholders in Saudi Arabia to obtain their standpoints regarding the topics involved in these questions. To answer question six and seven, this research used secondary data from three sources namely; annual reports, Bloomberg Database, and Tadawul website (the capital market official website), and regression analysis

was performed to examine the impact of CG on major shareholders and their different categories for the period covering from 2013 to 2017.

This chapter presents a conclusion of this research by providing (i) summary of the emergence and evolution of CG in Saudi Arabia; (ii) an integration between the findings of the quantitative and qualitative assessments (iv) contributions to knowledge; (v) limitations of the research; and finally (vi) recommendations for future research.

8.2 Evolution of Corporate Governance in Saudi Arabia

This section attempts to answer the first research question which is: what is the extent of CG evolution in Saudi Arabia? To begin with, Saudi Arabia is a totally Islamic kingdom which is dominantly influenced by Sharia laws (Hussainey and Al-Nodel, 2008; Safieddine, 2009; Al-Matari et al., 2012). Therefore, CG regulations within the country seem to be affected by such Islamic teachings. In addition, CG regulations are also influenced by social norms that arguably still exists and supported by the society (Hussainey and Al-Nodel, 2008; Boytsun et al., 2011; Baydoun et al., 2013). The Saudi economy is considered one of the largest emerging economies (Al-Filali and Gallarotti, 2012). According to Al-Matari et al. (2012), it has gained an important economic ranking by being a member of the world's largest 20 economies (G20). Therefore, the unique characteristics of the Saudi business environment and the importance of the Saudi economy were influential factors in the development of CG regulations. Additionally, political ties have served also as a motive in developing CG regulations (Hussainey and Al-Nodel, 2008). Such characteristics of the Saudi economic, social, political, and religious settings have contributed to the uniqueness of the Saudi context which may have a distinct impact on CG system within the kingdom.

As discussed in Chapter Four, the evolution of CG regulations in Saudi Arabia has been mainly motivated by two primary factors (Al kahtani, 2013). First, the need to reform the economy and the capital market in the kingdom. Second, to increase the level of accountability within firms. The emergence of CG in Saudi Arabia is believed to have begun by establishing the Supreme Economic Council in 1999 to supervise the country's economic regulations and policies, which is based on the principles of comprehensive social welfare and a free-market economy. In the following year, the Saudi Arabian General Investment Authority (SAGIA) was formed to oversee all investment-related affairs within the kingdom. Nevertheless, the

substantial history point for the emergence of CG was the establishment of the Capital Market Authority (CMA) in 2003, which is also considered the actual launch of CG developments (Al-Abbas, 2009; Alshehri and Solomon, 2012; Al-Moataz and Hussainey, 2012). The second crucial factor that motivated CG development was the infamous crash of the Saudi capital market in 2006 that caused equity losses of \$480 billion accounting for 53% of the entire market valuation. This market crash has driven the CMA to further reform CG regulations aiming at gaining investors' confidence in the market (Ramady, 2010).

As a result, the CMA published the CGC 2006 on 12 November 2006. This version of the code was formed to govern listed companies in the capital market to ensure implementing higher CG standards aiming to protect the interests of stakeholders, especially shareholders. According to Alshehri (2012), the code is affected by the CG principles issued by the OECD in 2004 along with the Cadbury and Greenbury reports (Riyadh Chamber of Commerce and Industry, 2007). The CGC 2006 presents voluntary guidelines which follow the UK 'comply or explain' approach. It is argued that such approach is effective in diffuse ownership structured markets (Aguilera and Cuervo-Cazurra, 2009; Al-Abbas, 2009; Seidl et al., 2013).

The CGC 2006 was formed of five main sections that consist of nineteen Articles. The first section presents the preliminary provisions accompanied with definitions and any linkage to other enforced laws within the kingdom such as the Saudi CA 1965. The second section describes the provisions that concern the shareholders rights and the general assembly. The third section of the code consist of policies related to disclosure and transparency. The fourth section of the CGC 2006 policies that assists in enhancing the role and functions of boards. Finally, the fifth section of the code presents only closing provisions.

In addition, this version of the code has been revised by the CMA repeatedly (Alshehri, 2012). The aim of such repetitive revisions is to mandate certain provisions. The CMA issued four decisions in 2008, 2010, 2011 and 2012 that order listed companies to implement certain provision within the code. For example, the CMA decision 1-36-2008 dated 10 November 2008 mandated Article 9 that explains disclosure requirements of board of directors, and effective immediately. The same decision has also mandated Article 12 that regulates the membership of the majority of board members, effective from 1 January 2009. Similar decisions are presented in Table 4.2 in Chapter Four.

The CGC 2017 is the second version of the code of CG regulations in Saudi Arabia. It was released by the CMA as a fully mandatory code, effective from 1 January 2018. The new CGC

2017 is formed of twelve main sections that include ninety-eight Articles. It also presents a new model of compensation of board members. The new guidelines have enhanced the effectiveness of CG policies in several aspects such as shareholders' rights, board responsibilities and rights, transparency and disclosure issues, and more clarity of boards functions. The formation of the CGC 2017 was motivated by the fact that the MoCI and the CMA aim to enable listed companies to implement CG practice in an easier and practical way (Al Ahmary, 2018). The CGC 2017 is believed to have the ability to positively impact the whole business environment rather than only firm-level activities (Alotaibi, 2015). One of the positive effects of the new code is the harmonisation between the new CG regulations and the regulations issued in the new CA 2015. The table below presents a comparison between the CGC 2006 and CGC 2017.

| Code Aspect | CGC 2006 | CGC 2017 |
|----------------------------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Issuance Date | November 2006 | April 2017 |
| Number of sections | 5 | 12 |
| Number of Articles | 19 | 98 |
| Mandate level | Comply or Explain – some provisions became mandatory over the years. | Fully mandatory |
| Regulator | The CMA | The CMA |
| Motivations | <ul style="list-style-type: none"> • Collapse of the capital market • Restoring investors' confidence • Protection of shareholders and stakeholders' interests | <ul style="list-style-type: none"> • Enhancing the regulatory oversight of listed firms • Harmonising the CG regulations with the CA 2015 |
| Base of Regulations | The Cadbury Report & the OECD principles | International standards published by the: <ul style="list-style-type: none"> • OECD • International Governance Network • Basel Committee on Banking Supervision • International Financial Institute • UK Corporate Governance Code |
| Main Features | <ul style="list-style-type: none"> • Assisting BOD to reduce agency cost • Introducing new key terms and regulations • Mainly influenced by the Anglo-American CG model | <ul style="list-style-type: none"> • More emphasis on shareholders rights • More emphasis on duties and rights of BOD |

| Code Aspect | CGC 2006 | CGC 2017 |
|-------------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| | <ul style="list-style-type: none"> • Not compatible with concentrated ownership structure. • Overlapping with other laws • No distinction between major and minor shareholders • No regulations for internal control process • No emphasis on the external auditor role | <ul style="list-style-type: none"> • More elaboration on disclosure & transparency practices • Enhanced demonstration of BOD functions and responsibilities • Underlining new definitions of the key terms • Encouraging shareholders activism • Establishing new board sub-committees |

Table 8.1: Comparison between the CGC 2006 and CGC 2017

Source: constructed by the researcher

8.3 Summary of Main Findings

This section summarises the main descriptive statistics of this research as well as the integrated findings of the quantitative and qualitative assessments.

8.3.1 Descriptive Statistics

The following bullet points reveal a summary of the findings of the descriptive statistics that relate to dependent and independent variables:

- Major shareholdings have been growing from 31% in 2013 to 37% in 2017 which is consistent with findings in the UK and US as reported by Aggarwal et al. (2010), Chung and Zhang (2011), and Hawas and Tse (2016).
- The average mean of major shareholdings in the Saudi capital market is 34%, which is close to the average means in the UK and US markets (i.e. Aggarwal et al., 2010; Hawas and Tse, 2016).
- Among major shareholders categories, the highest average mean refers to the governmental institutions (MAJOR2), other firms (MAJOR3), royal investors

(MAJOR8) and funds and insurance firms (MAJOR6), with averages of 25.15%, 24.40%, 23.62%, and 22.92% respectively.

- The lowest average mean refers to wealthy individuals (MAJOR5) with an average of 11.33%.
- The CG compliance rate of CG score (i.e. Provisions for shareholders' rights and general assembly) has raised from 82% in 2013 to 98% in 2017. The rate has shown drops in 2015 and 2016 but it kept rising to the year end of 2017.
- The average mean of the number of board members from 2013 to 2017 is 8 on average which is slightly lower than the average mean in the UK and US as found by Bhagat and Black (2002) and Habbash (2010) respectively.
- The results showed that 90% of board members within listed firms are independent or/and NEDs, which comply with the CGC 2006 that requires the majority of board members must be independent/NEDs.

8.3.2 Integration Between the Findings of Quantitative and Qualitative Assessments

8.3.2.1 Major Shareholdings and CG Score

The regression analysis has revealed that total major shareholdings have a significant negative relationship with CG score. This shows that major shareholders in the Saudi capital market avoid investing in listed firms that implement CG mechanisms relating to voting rights and general assembly. The findings of semi-structured interviews explain such a result as R1 claims that such mechanisms can cause loss of power by major shareholders as they are responsible for monitoring and controlling their wealth invested in the market. In addition, voting rights mechanisms would have a relatively more impact on major shareholders since they own large stakes (R11). Therefore, using such mechanisms in general assemblies would negatively affect the ability of major shareholders to appoint trustworthy directors in their investee firms (R2). Appointing undesired board members may direct the firm toward different strategic goals (R8).

As shown in Chapter Three and Five, prior literature has shown a controversy regarding family ownership in listed companies. Therefore, this research decided to exclude major shareholdings of wealthy families from the sample intending to examine the changes that may occur in the relationship between CG and major shareholdings. The regression results revealed that the new modified sample has in fact a positive relationship with CG score, but statistically insignificant.

This is consistent with responses of a number of interviewees who expressed that they are convinced that such mechanisms are in the benefit of firms as well as quality and reliability of published information (R6, R4 and R10).

Regarding the impact of CG score on different categories of major shareholders, the regression analysis revealed mixed results. It showed that only three categories have a positive relationship with CG score namely (i) individual investors; (ii) royal investors; and (iii) other institutional investors. However, the relationship is only statistically significant with individual investors. This is consistent with responses of R8 and R9 (Wealthy individual investors) who voiced their support for such mechanisms in the CG score.

On the other hand, the regression results of major shareholdings of wealthy families show a significant negative linkage to CG score. This is explicitly expressed by two interviewees of wealthy families category (R1 and R2). They stated that implementing such mechanisms would affect their primary objectives of investment, which is commonly based on social ties. Subsequently, their influence could be limited. Additionally, the rest of categories namely governmental institutions, insiders, financial firms and fund and insurance companies have shown a negative association with CG score, but statistically not significant. The qualitative assessments revealed mixed results among these categories which explains the insignificant relationship. For instance, R11 stated that such mechanisms are not effective in regard to shareholders since they are mainly interested in dividends distributions in general assemblies. However, R4 indicated that such mechanism motivates shareholders to be more active and their interests are now the main concern in such assemblies.

8.3.2.2 Major Shareholdings and Board Quality

Regarding the impact of board quality on shares selection of major shareholders, the integrated results of quantitative and qualitative assessments can be presented in regard to two aspects namely (i) board size and (ii) board composition.

8.3.2.2.1 Board Size

In relation to board size, the regression results indicate that aggregate major shareholdings have a significant negative relationship with large boards. Eight interviewees (e.g., R1, R11 and R6) support this result as they revealed a number of obstacles that they encounter with large board including: (i) large boards are less effective than small boards; (ii) large boards cause delays in performing business activities; (iii) major shareholders encounter obstacles in monitoring large boards; and (iv) many large boards lack of knowledge and experience diversity. On the contrary, few interviewees (e.g., R9) prefer large boards as long as they are consisting of competent directors specialising in different backgrounds.

In regard to preferences of the different categories of major shareholders, the regression analysis indicated that board size is statistically significant and negatively related to wealthy families, financial firms, insurance firms, royal investors, and other institutional investors. Similar views have been revealed by some interviewees of these categories (i.e. R1, R10 and R11). In contrast, the regression results of governmental institutions, individual investors, and insiders have presented an insignificant relationship to board size even though R9 stated that large boards are actually in the firm's benefit.

8.3.2.2.2 Board Composition

The regression analysis examines whether the presence of independent and non-executive directors is preferred by major shareholders. The results show that there is a negative relationship between total major shareholdings and board independence, but statistically insignificant. However, the results show that board independence is statistically significant and negatively related to wealthy families shareholdings. The qualitative assessment is consistent with result as two interviewees from wealthy families category (R1 and R3) revealed their dislike for having a board that consists of majority independent members. In contrast, the only category that showed a significant positive association with board independence is insiders. This is explained by an interviewee of this category (R7) who stated that board independence is needed especially in large firms. The regression analysis has shown no significant relationship between board independence and the rest of categories, which can be linked to R9 who argues that board independence is a complicated issue within the Saudi capital market.

Regarding board NEDs, the regression results revealed a significant positive relationship between total major shareholders and the presence of NEDs. On the contrary, the regression results of major shareholdings of wealthy families, fund and insurance, and royal investors have shown that they are significantly and negatively associated with NEDs. The qualitative assessment has provided evidence of this result as R1 and R2 expressed their preference for CEOs as they are viewed to be more competent and trustworthy in performing board duties. Nevertheless, R10 claims that the role of board directors is concerned with the macro-level of firms. Thus, NEDs can perform their duties properly.

Based on the main findings of both quantitative and qualitative assessments of this research, it is evident that the only category of major shareholders that in both assessments have shown a significant negative relationship with CG is wealthy families category. The qualitative assessment of the rest of categories have provided mixed results concerning CG preferences which explains the insignificant relationship revealed by the regression analysis. Therefore, the results fail to provide empirical support to the findings reported by prior studies that claim CG is important to major shareholders (Giannetti and Simonov, 2006; Ferreira and Matosm, 2008; Khurshed et al., 2011; Hawas and Tse, 2016).

8.4 Research Contributions

This thesis extends the CG literature by concentrating on the capital market in Saudi Arabia which is a less regulated market compared to other markets in developed countries. CG regulations vary among different markets as some of them are imposed as mandatory standards whereas in other markets are still voluntary guidelines. This thesis emphasis on the Saud capital where CG regulations consisted of both mandatory and voluntary standards.

One of this thesis contributions is the attempt to provide new insights that assist in reducing agency problems. Prior studies have examined the role of institutional investors within the Saudi capital market (e.g., Bukhari, 2014; Alakkas, 2016) with little attention to the effect of CG on investment decisions of major investors and their different categories. This thesis also contributes to literature by discussing the concerns of major investors regarding the CG practices and reforms. The output of such discussion can provide policy makers with distinctive views that assist them in future CG reforms, which helps in enhancing corporate transparency and the protection of shareholders' interests. This is in turn would assist in reducing agency

costs and enable corporate board to accomplish their duties properly. In addition, this is also expected to elevate major shareholders activism within the capital market, which is one way of mitigating agency problems rather than ignoring their importance and role that leads to their passiveness.

Moreover, due to the unique local settings of Saudi Arabia (discussed in Chapter Four), the findings of prior studies in emerging markets may not be applicable to Saudi Arabia. This encouraged the researcher to use mixed method to examine whether CG practices have an impact on investment decisions of major shareholders in Saudi Arabia, who own a large proportion of shares within the Saudi capital market. The findings of this thesis help in filling the gap in the literature that examine the relationship between CG and shareholders in Saudi Arabia and provide new insights of the perceived impact of CG on investors' confidence.

In addition, this research provides the literature with new and important empirical evidence on the impact of CG on major shareholdings in the Saudi capital market. It also distinguishes between different categories of major shareholders that can assist in investigating their distinct preferences in regard to CG. The new evidence provided by this thesis can extend the literature that examines the impact of major shareholdings on firm value and practices with influential insights.

According to Zattoni et al. (2013), the problem arising because of the disagreement of CG findings is related to the lack of quantitative data to support interpretations of findings. This encourages researchers to employ mixed methods in their studies to examine interactions among results of such methods (Boyd et al., 2012; Molina-Azorin, 2012; Zattoni et al., 2013). It is argued that mixed methods research assists in obtaining more reliable results compared to a mono-method research (Boyd et al., 2012; Molina-Azorin, 2012). As a result of such calls for employing mixed and unlike many prior studies concerning CG and listed firms in Saudi Arabia, this research employs triangulation (i.e. mixed methods, quantitative, and qualitative). The research has also considered different categories of major shareholders within the Saudi capital market in quantitative and qualitative assessments, which is rarely achieved in a developing country. Given this, this thesis contributes to the CG literature by demonstrating how the results of quantitative and qualitative assessments are integrated to investigate the CG impact on major shareholdings. To the best of the researcher's knowledge, no research has examined CG impact on shares selection of major shareholders in a developing country, particularly Saudi Arabia, by employing triangulation framework.

The secondary data of this research have been collected manually from three different sources such as annual reports. Although this thesis used three sources, annual reports is considered the major reporting document compared to other published reports that are deemed supplementary Knutson (1992). This helped the researcher in obtaining balanced panel data unlike previous researches. Moreover, the sample size of this research (485 observations) is larger than other samples examined in prior studies concerning Saudi companies. For instance, the sample size in Alsaeed (2006) was limited to 40 firms in 2003. Also, Hussainey and Al-Nodel (2008) and Al-Nodel and Hussainey (2010) selected 64 and 37 companies, respectively. Additionally, data of 52 companies covering two-year period have been selected by Al-Moataz and Hussainey (2012), while Al-Janadi et al. (2016) selected a sample of 87 firms in 2006 and 2007 only. Finally, Al-Sahafi et al. (2019) used only the bank industry data from 2014 to 2017.

In order to gain an insightful understanding of the impact of CG on major shareholdings, this research also uses semi-structured interviews to explore major shareholders preferences and views regarding CG and its impact on their shares selection. Along with the three sources used for obtaining secondary data, semi-structured interviews help in minimising the limitations of employing only research method or source and to assist in interpreting the unexplained findings from the quantitative assessment. Additionally, conducting semi-structured interviews contributes to the literature by evaluating the perception and awareness of CG practices among different categories of major shareholders within the Saudi capital market.

Moreover, it has been fourteen years since the issue of the CGC 2006, therefore, this research, seeks to explore the impact that CG has on Saudi major shareholders and whether it plays a role during their investment decision-making after all of these years. Additionally, these interviews intended to reveal the views and preferences of major shareholders in regard to CG practices and role, which can be utilised by policy makers to develop and consider further reforms and development to the CG regulations in Saudi Arabia.

Finally, this research contributes to the literature by using a rarely used variable and its effect on major shareholders, which is the presence of a royal board member and the theoretical model and approaches of this thesis could be useful for further research based on the newly imposed CG code in Saudi Arabia.

8.5 Research Limitations

Although the previous section addressed research contributions, this research is subject to several limitations. One aspect of limitations is concerned with the quantitative part of this research. One of the main obstacles encountered by the researcher during the accomplishment of this research was the phase of secondary data collection. The researcher had to extract secondary data manually using content analysis from a number of sources namely annual reports (including management reports), Bloomberg Database, and the Saudi capital market website (Tadawul). This phase required substantial time and efforts since the data covered a five-year period of 97 listed firms with 485 observations where each observation included 22 variables. Apparently, there is no verified source that can provide ready data for CG purposes in Saudi Arabia. Therefore, there is an increase in the risk of human errors while inputting data into spreadsheets which can impact the reliability of employed data in this research. Even though the sample size of this research is larger than other studies concerning CG in Saudi Arabia, the generalisability of the results can be enhanced by obtaining larger sample.

Additionally, this research was limited to a five-year period due to the unavailability of data related to prior periods. Tadawul and listed companies' websites provide annual reports of a limited number of years (usually five years only). Using a longer period is deemed to portray a more insightful understanding of the issues examined in this research. However, even if such data were available, based on the researcher work for the master's degree dissertation in 2009, the disclosure level was weaker and cannot be compared to the level achieved recently.

Another aspect of limitations is linked to the qualitative assessment of this research. First, the quality of knowledge of specifically two interviewees seemed insufficient in regard to CG issues. Fortunately, the researcher was able to arrange for interviews with alternative investors. Second, few interviewees seemed reluctant to answer some questions or provide direct answers which forced the researcher to ask such questions differently as an attempt to obtain clearer responses. Third, none of interviewees granted the researcher a permission to use devices to record the conversation, which appears to be a common issue in developing countries (Alghamdi, 2012). The problem in this situation is that not everything that was discussed can be immediately noted by the researcher or some of such notes could become incomplete or inaccurate. However, the researcher revised all notes right after each interview to clarify and/or add on some unwritten responses to increase the reliability of data collected.

Furthermore, Saudi Arabia is quite a large country. The largest three cities in which most companies operate are in the eastern province (Dammam), the western province (Jeddah), and the capital city Riyadh which is in the middle part of the country. Therefore, arranging for interviews in these three cities was a hard task since travelling by airplane was time and cost-consuming due to lack of available bookings at the time that an interviewee is free. This situation limited the number of interviewees that can be included in the research sample. As a result, some interviews were conducted via telephone.

Finally, one of the research limitations is the issue of generalisability. This research concentrated on listed companies in the Saudi capital market where CG framework is still in the process of development and it is impacted by the local settings of the kingdom. Therefore, the findings of this research may not be applicable to other countries due to differences in the legal, economic, political, social, and religious systems.

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Appendices

Appendix A: Questions and Letter of Semi-Structured Interviews



INTERVIEW QUESTIONS

TOPIC ONE: INTRODUCTION

1. Introduction
2. Thank for time, and ask permission to record the interview
3. Mention the objectives and importance of this interview
4. Assure interviewee of absolute confidentiality
5. Interviewee information such as: name (optional)/position/qualifications/number of years of experience.

TOPIC TWO: THE UNDERSTANDING OF CG AND ITS IMPORTANCE

1. What is your definition of CG?
2. To what extent do you think CG is important in the business field?
3. If the Saudi market had not experienced a crash in 2006, would there be a need for CG regulations nowadays?
4. How well do you think listed companies are complying with CG laws?
5. Does your entity follow CG guidelines (If the shareholder invests through his/her firm)? For how long?
6. What improvements have CG made to your entity?
7. What are the shortcomings of CG implementation of your entity? If any.

TOPIC THREE: THE ASSESSMENT OF CG MECHANISMS

1. Are you familiar with the meaning of CG mechanisms?
2. What is your view about board structure and composition?
3. What is your view about board independence?
4. What is your view about the importance of board sub-committees?
5. What is your view about the transparency and disclosures of listed companies?
6. Do you think that recent CG reforms have helped raising the attention to this aspect?
7. How well do you think listed companies protect their investors?
8. How well do you think current legislations protect investors' rights?
9. To what extent do listed companies help investors' exercise their rights?

TOPIC FOUR: THE ROLE OF MAJOR SHAREHOLDERS IN THE SAUDI MARKET

1. What role do you think major shareholders can play in capital markets?
2. To what extent do major shareholders exercise their rights in order to improve or change CG practices in investee firms?

TOPIC FIVE: INVESTORS' INTEREST IN CG PRACTICES

1. What attracts you the most in CG practice in general?
2. What are the firm characteristics that attract you the most (investment-wise)? Why?
3. What CG mechanisms do you think are most important to shareholders? And why?
4. What are the least important CG mechanisms? And why?

TOPIC SIX: THE ROLE OF CG IN THE SHARE SELECTION PROCESS OF INVESTORS

1. Besides other information, what are the main aspects of CG do you examine in a company when evaluation share buying decisions? And why?
2. How strong your potential investments are related to CG practices?



المكرم الأخ العزيز:
تحية طيبة وبعد ..

أود أن أحيط سعادتكم بأني أحد طلاب الدكتوراه بجامعة نيوكاسل بالمملكة المتحدة - كلية إدارة الأعمال، قسم المحاسبة، وأقوم في الوقت الحالي ببحث عن مدى تأثير أنظمة وقوانين حوكمة الشركات المطبقة في الشركات المدرجة في سوق المال على القرارات الاستثمارية لكبار المستثمرين. هذه بعض من المواضيع التي سيتم التطرق لها في المقابلة الشخصية مع سعادتكم والتي هي جزء من رسالة الدكتوراه والتي من أهدافها تقييم مثل هذه الآليات التي اكتسبت مؤخراً أهمية كبيرة خاصة بعد الأزمة المالية العالمية، وكذلك حظيت باهتمام كبير من قبل هيئة سوق المال والجهات ذات العلاقة في المملكة العربية السعودية.

وحقيقة أنا على أمل أن تقوم بإجراء هذه المقابلة معكم على أساس خيرتكم في هذا المجال من أجل التعرف على مدى هذا التأثير وقياسه حتى يمكن لنا المساهمة في تحسين آليات الحوكمة وضمان جودتها. وسأكون ممتن لكم في حال قبولكم لإجراء المقابلة.

أخيراً ، أود أن أؤكد لكم أنه سيتم التعامل مع المعلومات وأرائكم الشخصية بشكل سري. وتفضلوا بقبول خالص شكري وتقديري.

أحمد بن علي القرني
محاضر في كلية إدارة الأعمال
جامعة الإمام عبدالرحمن بن فيصل
E-mail: ahmed.alfaraj2@newcastle.ac.uk
00966 11 700 700

Appendix B: CG Score Variables

| SECTION | ARTICLE | # | Corporate Governance Provisions |
|-----------------------------------------------------|---------|---|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Shareholders Rights Related to the General Assembly | A.5.C | 1 | Date, place, and agenda of the General Assembly shall be specified and announced by a notice, at least 20 days prior to the date of the meeting; invitation for the meeting shall be published in the Exchange's website, the company's website and in two newspapers of voluminous distribution in the Kingdom. Modern high tech means shall be used in communicating with shareholders. |
| | A.5.F | 2 | In preparing the General Assembly's agenda, the Board of Directors shall take into consideration matters shareholders require to be listed in that agenda; shareholders holding not less than 5% of the company's shares are entitled to add one or more items to the agenda. upon its preparation. |
| Voting Rights | A.6.B | 3 | In voting in the General Assembly for the nomination to the board members, the accumulative voting method shall be applied. |
| | A.6.D | 4 | Investors who are judicial persons and who act on behalf of others - e.g. investment funds- shall disclose in their annual reports their voting policies, actual voting, and ways of dealing with any material conflict of interests that may affect the practice of the fundamental rights in relation to their investments. |
| Main Functions of the Board of Directors | A.10.C | 5 | Drafting a Corporate Governance Code for the company that does not contradict the provisions of this regulation, supervising and monitoring in general the effectiveness of the code and amending it whenever necessary. |
| | A.10.D | 6 | Laying down specific and explicit policies, standards and procedures, for the membership of the Board of Directors and implementing them after they have been approved by the General Assembly. |
| | A.10.E | 7 | Outlining a written policy that regulate the relationship with stakeholders with a view to protecting their respective rights; in particular, such policy must cover the following: (5) The Company's social contributions. |
| Formation of the Board | A.12.I | 8 | Judicial person who is entitled under the company's Articles of Association to appoint representatives in the Board of Directors, is not entitled to nomination vote of other members of the Board of Directors. |

Appendix C: Research Data

For the multiple regressions, the model variables for the quantitative assessment of this research are explained in the following table:

| Variable | Type | Details | Source |
|---------------------------|-----------------------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|---------------------------------------------------------------|
| Total Major Shareholdings | Dependant Variable | This dependant variable will be calculated as the percentage of shares owned by shareholders who own at least 5% of the firm shares. | Annual Reports & Bloomberg |
| CG Quality (1) | Independent Variables | This research will use an score of CG mechanisms that are influential on investment decisions according to interviewees' responses. (Phase two of statistical tests). | Interviews |
| CG Quality (2) | Independent Variables | For comparisons reasons, this research uses 8 CG mechanisms that are more related to shareholders rights such as rights related to the general assembly, voting rights and other policies forming their relationship with the board. | Annual Reports & Code of CG |
| Board Quality | Independent Variables | This study uses 5 board characteristics as measurements of board quality namely: board size, independence, NEDs, board meetings, and presence of royal members. | Annual Reports |
| Control | Control Variables | This research uses 9 control variables based on an assessment of previous literature by Dahlquist & Robertsson (2001). The chosen variables include firm size, leverage, turnover, dividend yield, profitability, firm value, stock return, share price, and firm age. | DataStream & Bloomberg & Tadawul (The capital market website) |

Appendix D: Variables Measurement

| # | VARIABLE | DESCRIPTION | SOURCE | SHORTCUT |
|----|----------------------------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|--------------------------------------------|-----------|
| 1 | MAJOR SHAREHOLDINGS | The total percentage of shares owned by shareholders with at least 5% of the firm shares | Annual Reports & Bloomberg | MAJORHOLD |
| 2 | CORPORATE GOVERNANCE SCORE | A collection of eight CG provisions related to Shareholders rights and Voting rights. If a company adopts the item, a score of 1 is given and 0 otherwise. Then we sum all scores for each company and then divide it by number of items. | Annual reports & Bloomberg | CGSCORE |
| 3 | BOARD SIZE | Number of board members as of 31 st December of each year. | Annual Reports | BODSIZE |
| 4 | BOARD INDEPENDENCE | Number of independent members in the board as of 31 st December of each year. | Annual Reports | BODINDP |
| 5 | BOARD NEDs | Number of NEDs in the board as of 31 st December of each year. | Annual Reports | BODNEDS |
| 6 | BOARD MEETINGS | Number of annual board meeting during the fiscal year | Annual Reports | BODMEET |
| 7 | ROYAL MEMBER ON BOARD | Number of Royal individuals as members in the board as of 31 st December of each year. | Annual Reports | BODROYAL |
| 8 | FIRM SIZE | Firms market value as of year-end (in ,000) | DataStream | FSIZE |
| 9 | FIRM LEVERAGE | The percentage of total debt to total assets | Bloomberg | FLEV |
| 10 | SHARE TURNOVER | Annual share volume divided by adjusted shares outstanding (Number of Shares Outstanding/Adjustment factor) | DataStream | FTURN |
| 11 | DIVIDEND YIELD | The dividends per share to market price year-end | Bloomberg | FDY |
| 12 | ROA | Return on Assets (Profitability Ratio) | Bloomberg | FROA |
| 13 | TOBIN'S Q | The Sum of total assets plus market value of equity minus book value of equity divided by total assets | DataStream | FTOBIN |
| 14 | SHARE RETURN | The appreciation in the price divided by the original price of the stock | DataStream | FRETURN |
| 15 | SHARE PRICE | Market price as of 31st December of each year (in Saudi Riyal) | DataStream | FPRICE |
| 16 | FIRM AGE | Based on the firm's establishment date (YEARS) | Tadawul (The Saudi capital market website) | FAGE |

Appendix E: Descriptive Statistics of All Categories of Major Shareholders

| Category | N | Mean | Median | MIN | MAX | SD | Skewness | Kurtosis |
|-----------------|----------|-------------|---------------|------------|------------|-----------|-----------------|-----------------|
| MAJOR1 | 135 | 22.44 | 16.42 | 5.00 | 70.00 | 18.98 | 1.150 | 0.179 |
| MAJOR2 | 175 | 25.33 | 15.72 | 5.00 | 97.89 | 24.22 | 1.457 | 1.307 |
| MAJOR3 | 135 | 24.57 | 19.51 | 5.00 | 60.33 | 17.13 | 0.430 | -1.082 |
| MAJOR4 | 80 | 16.46 | 11.25 | 5.00 | 55.50 | 12.70 | 0.956 | 0.703 |
| MAJOR5 | 90 | 11.94 | 7.89 | 5.00 | 32.72 | 7.89 | 1.059 | 0.636 |
| MAJOR6 | 70 | 22.95 | 23.50 | 5.00 | 50.07 | 10.30 | 0.310 | 0.382 |
| MAJOR7 | 50 | 18.89 | 12.69 | 5.00 | 42.00 | 12.40 | 0.600 | -1.090 |
| MAJOR8 | 45 | 23.61 | 14.89 | 7.30 | 95.00 | 26.30 | 2.290 | 3.907 |

Appendix F: The First Corporate Governance Code 2006

CAPITAL MARKET AUTHORITY

**CORPORATE GOVERNANCE REGULATIONS
IN THE KINGDOM OF SAUDI ARABIA**

Issued by the Board of Capital Market Authority
Pursuant to Resolution No. 1/212/2006
dated 21/10/1427AH (corresponding to 12/11/2006)
based on the Capital Market Law
issued by Royal Decree No. M/30
dated 2/6/1424AH

**Amended by Resolution of the Board
of the Capital Market Authority Number 1-1-2009
Dated 8/1/1430H Corresponding to 5/1/2009G**

**English Translation of the Official Arabic Text
Arabic is the official language of the Capital Market Authority**

**The current version of these Rules, as may be amended, can be found aton
the CMA website: www.cma.org.sa**

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PART 1 PRELIMINARY PROVISIONS

Article 1: Preamble

- a) These Regulations include the rules and standards that regulate the management of joint stock companies listed in the Exchange to ensure their compliance with the best governance practices that would ensure the protection of shareholders' rights as well as the rights of stakeholders.
- b) These Regulations constitute the guiding principles for all companies listed in the Exchange unless any other regulations, rules or resolutions of the Board of the Authority provide for the binding effect of some of the provisions herein contained.
- c) As an exception of paragraph (b) of this article, a company must disclose in the Board of Directors' report, the provisions that have been implemented and the provisions that have not been implemented as well as the reasons for not implementing them.

Article 2: Definitions

- a) Expression and terms in these regulations have the meanings they bear in the Capital Market Law and in the glossary of defined terms used in the regulations and the rules of the Capital Market Authority unless otherwise stated in these regulations.
- b) For the purpose of implementing these regulations, the following expressions and terms shall have the meaning they bear as follows unless the contrary intention appears:

Independent Member¹: A member of the Board of Directors who enjoys complete independence. By way of example, the following shall constitute an infringement of such independence:

¹ The Board of the Capital Market Authority issued its resolution number (1-10-2010) Dated 30/3/1431H corresponding to 16/3/2010G amending the definition of "Independent Member" in paragraph (b) of Article 2 of these Regulations to include as infringements of independence the ownership of 5% or more of the company or its group by the member of the Board of Directors or a representative of a legal entity which owns 5% or more of the company or its group. The amendments shall be applied on companies that apply for listing on the Saudi Stock Exchange (Tadawul) from the date of its publication. And will be applied on companies listed on the Exchange upon the appointment of any member of the board, starting from the date of 1/1/2011.

1. he/she holds a controlling interest in the company or in any other company within that company's group.
2. he/she, during the preceding two years, has been a senior executive of the company or of any other company within that company's group.
3. he/she is a first-degree relative of any board member of the company or of any other company within that company's group.
4. he/she is first-degree relative of any of senior executives of the company or of any other company within that company's group.
5. he/she is a board member of any company within the group of the company which he is nominated to be a member of its board.
6. If he/she, during the preceding two years, has been an employee with an affiliate of the company or an affiliate of any company of its group, such as external auditors or main suppliers; or if he/she, during the preceding two years, had a controlling interest in any such party.

Non-executive director: A member of the Board of Directors who does not have a full-time management position at the company, or who does not receive monthly or yearly salary.

First-degree relatives: father, mother, spouse and children.

Stakeholders: Any person who has an interest in the company, such as shareholders, employees, creditors, customers, suppliers, community.

Accumulative Voting: a method of voting for electing directors, which gives each shareholder a voting rights equivalent to the number of shares he/she holds. He/she has the right to use them all for one nominee or to divide them between his/her selected nominees without any duplication of these votes. This method increases the chances of the minority shareholders to appoint their representatives in the board through the right to accumulate votes for one nominee.

Minority Shareholders: Those shareholders who represent a class of shareholders that does not control the company and hence they are unable to influence the company.

PART 2
RIGHTS OF SHAREHOLDERS AND THE GENERAL ASSEMBLY

Article 3: General Rights of Shareholders

A Shareholder shall be entitled to all rights attached to the share, in particular, the right to a share of the distributable profits, the right to a share of the company's assets upon liquidation; the right to attend the General Assembly and participate in deliberations and vote on relevant decisions; the right of disposition with respect to shares; the right to supervise the Board of Directors activities, and file responsibility claims against board members; the right to inquire and have access to information without prejudice to the company's interests and in a manner that does not contradict the Capital Market Law and the Implementing Rules.

Article 4: Facilitation of Shareholders Exercise of Rights and Access to Information

- a) The company in its Articles of Association and by-laws shall specify the procedures and precautions that are necessary for the shareholders' exercise of all their lawful rights.
- b) All information which enable shareholders to properly exercise their rights shall be made available and such information shall be comprehensive and accurate; it must be provided and updated regularly and within the prescribed times; the company shall use the most effective means in communicating with shareholders. No discrepancy shall be exercised with respect to shareholders in relation to providing information.

Article 5: Shareholders Rights related to the General Assembly

- a) A General Assembly shall convene once a year at least within the six months following the end of the company's financial year.
- b) The General Assembly shall convene upon a request of the Board of Directors. The Board of Directors shall invite a General Assembly to convene pursuant to a request of the auditor or a number of shareholders whose shareholdings represent at least 5% of the equity share capital.
- c) Date, place, and agenda of the General Assembly shall be specified and announced by a notice, at least 20 days prior to the date the meeting;

invitation for the meeting shall be published in the Exchange' website, the company's website and in two newspapers of voluminous distribution in the Kingdom. Modern high tech means shall be used in communicating with shareholders.

- d) Shareholders shall be allowed the opportunity to effectively participate and vote in the General Assembly; they shall be informed about the rules governing the meetings and the voting procedure.
- e) Arrangements shall be made for facilitating the participation of the greatest number of shareholders in the General Assembly, including *inter alia* determination of the appropriate place and time.
- f) In preparing the General Assembly's agenda, the Board of Directors shall take into consideration matters shareholders require to be listed in that agenda; shareholders holding not less than 5% of the company's shares are entitled to add one or more items to the agenda upon its preparation.
- g) Shareholders shall be entitled to discuss matters listed in the agenda of the General Assembly and raise relevant questions to the board members and to the external auditor. The Board of Directors or the external auditor shall answer the questions raised by shareholders in a manner that does not prejudice the company's interest.
- h) Matters presented to the General Assembly shall be accompanied by sufficient information to enable shareholders to make decisions.
- i) Shareholders shall be enabled to peruse the minutes of the General Assembly; the company shall provide the Authority with a copy of those minutes within 10 days of the convening date of any such meeting.
- j) The Exchange shall be immediately informed of the results of the General Assembly.

Article 6: Voting Rights

- a) Voting is deemed to be a fundamental right of a shareholder, which shall not, in any way, be denied. The company must avoid taking any action which might hamper the use of the voting right; a shareholder

must be afforded all possible assistance as may facilitate the exercise of such right.

- b) In voting in the General Assembly for the nomination to the board members, the accumulative voting method shall be applied.
- c) A shareholder may, in writing, appoint any other shareholder who is not a board member and who is not an employee of the company to attend the General Assembly on his behalf.
- d) Investors who are judicial persons and who act on behalf of others - e.g. investment funds- shall disclose in their annual reports their voting policies, actual voting, and ways of dealing with any material conflict of interests that may affect the practice of the fundamental rights in relation to their investments.

Article 7: Dividends Rights of Shareholders

- a) The Board of Directors shall lay down a clear policy regarding dividends, in a manner that may realize the interests of shareholders and those of the company; shareholders shall be informed of that policy during the General Assembly and reference thereto shall be made in the report of the Board of Directors.
- b) The General Assembly shall approve the dividends and the date of distribution. These dividends, whether they be in cash or bonus shares shall be given, as of right, to the shareholders who are listed in the records kept at the Securities Depository Center as they appear at the end of trading session on the day on which the General Assembly is convened.

PART 3

DISCLOSURE AND TRANSPARENCY

Article 8: Policies and Procedure related to Disclosure

The company shall lay down in writing the policies, procedures and supervisory rules related to disclosure, pursuant to law.

Article 9²: Disclosure in the Board of Directors' Report

In addition to what is required in the Listing Rules in connection with the content of the report of the Board of Directors, which is appended to the annual financial statements of the company, such report shall include the following:

- a) The implemented provisions of these Regulations as well as the provisions which have not been implemented, and the justifications for not implementing them.
- b) Names of any joint stock company or companies in which the company Board of Directors member acts as a member of its Board of directors.
- c) Formation of the Board of Directors and classification of its members as follows: executive board member, non-executive board member, or independent board member.
- d) A brief description of the jurisdictions and duties of the Board's main committees such as the Audit Committee, the Nomination and Remuneration Committee; indicating their names, names of their chairmen, names of their members, and the aggregate of their respective meetings.
- e) Details of compensation and remuneration paid to each of the following:

² The Board of the Capital Market Authority issued resolution Number (1-36-2008) Dated 12/11/1429H corresponding to 10/11/2008G making Article 9 of the Corporate Governance Regulations mandatory on all companies listed on the Exchange effective from the first board report issued by the company following the date of the Board of the Capital Market Authority resolution mentioned above.

1. The Chairman and members of the Board of Directors.
2. The Top Five executives who have received the highest compensation and remuneration from the company. The CEO and the chief finance officer shall be included if they are not within the top five.

For the purpose of this paragraph, “compensation and remuneration” means salaries, allowances, profits and any of the same; annual and periodic bonuses related to performance; long or short- term incentive schemes; and any other rights *in rem*.

- f) Any punishment or penalty or preventive restriction imposed on the company by the Authority or any other supervisory or regulatory or judiciary body.
- g) Results of the annual audit of the effectiveness of the internal control procedures of the company.

PART 4

BOARD OF DIRECTORS

Article 10: Main Functions of the Board of Directors

Among the main functions of the Board is the following:

- a) Approving the strategic plans and main objectives of the company and supervising their implementation; this includes:
 1. Laying down a comprehensive strategy for the company, the main work plans and the policy related to risk management, reviewing and updating of such policy.
 2. Determining the most appropriate capital structure of the company, its strategies and financial objectives and approving its annual budgets.
 3. Supervising the main capital expenses of the company and acquisition/disposal of assets.
 4. Deciding the performance objectives to be achieved and supervising the implementation thereof and the overall performance of the company.
 5. Reviewing and approving the organizational and functional structures of the company on a periodical basis.
- b) Lay down rules for internal control systems and supervising them; this includes:
 1. Developing a written policy that would regulates conflict of interest and remedy any possible cases of conflict by members of the Board of Directors, executive management and shareholders. This includes misuse of the company's assets and facilities and the arbitrary disposition resulting from dealings with the related parties.
 2. Ensuring the integrity of the financial and accounting procedures including procedures related to the preparation of the financial reports.

3. Ensuring the implementation of control procedures appropriate for risk management by forecasting the risks that the company could encounter and disclosing them with transparency.
 4. Reviewing annually the effectiveness of the internal control systems.
- c) Drafting a Corporate Governance Code for the company that does not contradict the provisions of this regulation, supervising and monitoring in general the effectiveness of the code and amending it whenever necessary.
- d) Laying down specific and explicit policies, standards and procedures, for the membership of the Board of Directors and implementing them after they have been approved by the General Assembly.
- e) Outlining a written policy that regulate the relationship with stakeholders with a view to protecting their respective rights; in particular, such policy must cover the following:
1. Mechanisms for indemnifying the stakeholders in case of contravening their rights under the law and their respective contracts.
 2. Mechanisms for settlement of complaints or disputes that might arise between the company and the stakeholders.
 3. Suitable mechanisms for maintaining good relationships with customers and suppliers and protecting the confidentiality of information related to them.
 4. A code of conduct for the company's executives and employees compatible with the proper professional and ethical standards, and regulate their relationship with the stakeholders. The Board of Directors lays down procedures for supervising this code and ensuring compliance there with.
 5. The Company's social contributions.
- f) Deciding policies and procedures to ensure the company's compliance with the laws and regulations and the company's obligation to disclose material information to shareholders, creditors and other stakeholders.

Article 11 : Responsibilities of the Board

- a) Without prejudice to the competences of the General Assembly, the company's Board of Directors shall assume all the necessary powers for the company's management. The ultimate responsibility for the company rests with the Board even if it sets up committees or delegates some of its powers to a third party. The Board of Directors shall avoid issuing general or indefinite power of attorney.
- b) The responsibilities of the Board of Directors must be clearly stated in the company's Articles of Association.
- c) The Board of Directors must carry out its duties in a responsible manner, in good faith and with due diligence. Its decisions should be based on sufficient information from the executive management, or from any other reliable source.
- d) A member of the Board of Directors represents all shareholders; he undertakes to carry out whatever may be in the general interest of the company, but not the interests of the group he represents or that which voted in favor of his appointment to the Board of Directors.
- e) The Board of Directors shall determine the powers to be delegated to the executive management and the procedures for taking any action and the validity of such delegation. It shall also determine matters reserved for decision by the Board of Directors. The executive management shall submit to the Board of Directors periodic reports on the exercise of the delegated powers.
- f) The Board of Directors shall ensure that a procedure is laid down for orienting the new board members of the company's business and, in particular, the financial and legal aspects, in addition to their training, where necessary.
- g) The Board of Directors shall ensure that sufficient information about the company is made available to all members of the Board of Directors, generally, and, in particular, to the non-executive members, to enable them to discharge their duties and responsibilities in an effective manner.

- h) The Board of Directors shall not be entitled to enter into loans which spans more than three years, and shall not sell or mortgage real estate of the company, or drop the company's debts, unless it is authorized to do so by the company's Articles of Association. In the case where the company's Articles of Association includes no provisions to this respect, the Board should not act without the approval of the General Assembly, unless such acts fall within the normal scope of the company's business.

Article 12³: Formation of the Board

Formation of the Board of Directors shall be subject to the following:

- a) The Articles of Association of the company shall specify the number of the Board of Directors members, provided that such number shall not be less than three and not more than eleven.
- b) The General Assembly shall appoint the members of the Board of Directors for the duration provided for in the Articles of Association of the company, provided that such duration shall not exceed three years. Unless otherwise provided for in the Articles of Association of the company, members of the Board may be reappointed.
- c) The majority of the members of the Board of Directors shall be non-executive members.
- d) It is prohibited to conjoin the position of the Chairman of the Board of Directors with any other executive position in the company, such as the Chief Executive Officer (CEO) or the managing director or the general manager.
- e) The independent members of the Board of Directors shall not be less than two members, or one-third of the members, whichever is greater.
- f) The Articles of Association of the company shall specify the manner in which membership of the Board of Directors terminates. At all times, the General Assembly may dismiss all or any of the members

³ The Board of the Capital Market Authority issued resolution Number (1-36-2008) Dated 12/11/1429H corresponding to 10/11/2008G making paragraphs (c) and (e) of Article 12 of the Corporate Governance Regulations mandatory on all companies listed on the Exchange effective from year 2009.

of the Board of Directors even though the Articles of Association provide otherwise.

- g) On termination of membership of a board member in any of the ways of termination, the company shall promptly notify the Authority and the Exchange and shall specify the reasons for such termination.
- h) A member of the Board of Directors shall not act as a member of the Board of Directors of more than five joint stock companies at the same time.
- i) Judicial person who is entitled under the company's Articles of Association to appoint representatives in the Board of Directors, is not entitled to nomination vote of other members of the Board of Directors.

Article 13: Committees of the Board

- a) A suitable number of committees shall be set up in accordance with the company's requirements and circumstances, in order to enable the Board of Directors to perform its duties in an effective manner.
- b) The formation of committees subordinate to the Board of Directors shall be according to general procedures laid down by the Board, indicating the duties, the duration and the powers of each committee, and the manner in which the Board monitors its activities. The committee shall notify the Board of its activities, findings or decisions with complete transparency. The Board shall periodically pursue the activities of such committees so as to ensure that the activities entrusted to those committees are duly performed. The Board shall approve the by-laws of all committees of the Board, including, *inter alia*, the Audit Committee, Nomination and Remuneration Committee.
- c) A sufficient number of the non-executive members of the Board of Directors shall be appointed in committees that are concerned with activities that might involve a conflict of interest, such as ensuring the integrity of the financial and non-financial reports, reviewing the deals concluded by related parties, nomination to membership of the Board, appointment of executive directors, and determination of remuneration.

Article 14⁴: Audit Committee

- a) The Board of Directors shall set up a committee to be named the “Audit Committee”. Its members shall not be less than three, including a specialist in financial and accounting matters. Executive board members are not eligible for Audit Committee membership.
- b) The General Assembly of shareholders shall, upon a recommendation of the Board of Directors, issue rules for appointing the members of the Audit Committee and define the term of their office and the procedure to be followed by the Committee.
- c) The duties and responsibilities of the Audit Committee include the following:
 1. To supervise the company’s internal audit department to ensure its effectiveness in executing the activities and duties specified by the Board of Directors.
 2. To review the internal audit procedure and prepare a written report on such audit and its recommendations with respect to it.
 3. To review the internal audit reports and pursue the implementation of the corrective measures in respect of the comments included in them.
 4. To recommend to the Board of Directors the appointment, dismissal and the Remuneration of external auditors; upon any such recommendation, regard must be made to their independence.
 5. To supervise the activities of the external auditors and approve any activity beyond the scope of the audit work assigned to them during the performance of their duties.
 6. To review together with the external auditor the audit plan and make any comments thereon.

⁴ The Board of the Capital Market Authority issued resolution Number (1-36-2008) Dated 12/11/1429H corresponding to 10/11/2008G making Article 14 of the Corporate Governance Regulations mandatory on all companies listed on the Exchange effective from year 2009.

7. To review the external auditor's comments on the financial statements and follow up the actions taken about them.
8. To review the interim and annual financial statements prior to presentation to the Board of Directors; and to give opinion and recommendations with respect thereto.
9. To review the accounting policies in force and advise the Board of Directors of any recommendation regarding them.

Article 15⁵: Nomination and Remuneration Committee

- a) The Board of Directors shall set up a committee to be named "Nomination and Remuneration Committee".
- b) The General Assembly shall, upon a recommendation of the Board of Directors, issue rules for the appointment of the members of the Nomination and Remuneration Committee, their remunerations, and terms of office and the procedure to be followed by such committee.
- c) The duties and responsibilities of the Nomination and Remuneration Committee include the following:
 1. Recommend to the Board of Directors appointments to membership of the Board in accordance with the approved policies and standards; the Committee shall ensure that no person who has been previously convicted of any offense affecting honor or honesty is nominated for such membership.
 2. Annual review of the requirement of suitable skills for membership of the Board of Directors and the preparation of a description of the required capabilities and qualifications for such membership, including, *inter alia*, the time that a Board member should reserve for the activities of the Board.
 3. Review the structure of the Board of Directors and recommend changes.

⁵ The Board of the Capital Market Authority issued resolution Number (1-10-2010) Dated 30/3/1431H corresponding to 16/3/2010G making Article 15 of the Corporate Governance Regulations mandatory on all companies listed on the Exchange effective from 1/1/2011.

4. Determine the points of strength and weakness in the Board of Directors and recommend remedies that are compatible with the company's interest.
5. Ensure on an annual basis the independence of the independent members and the absence of any conflict of interest in case a Board member also acts as a member of the Board of Directors of another company.
6. Draw clear policies regarding the indemnities and remunerations of the Board members and top executives; in laying down such policies, the standards related to performance shall be followed.

Article 16: Meetings of the Board

1. The Board members shall allot ample time for performing their responsibilities, including the preparation for the meetings of the Board and the permanent and ad hoc committees, and shall endeavor to attend such meetings.
2. The Board shall convene its ordinary meetings regularly upon a request by the Chairman. The Chairman shall call the Board for an unforeseen meeting upon a written request by two of its members.
3. When preparing a specified agenda to be presented to the Board, the Chairman should consult the other members of the Board and the CEO. The agenda and other documentation should be sent to the members in a sufficient time prior to the meeting so that they may be able to consider such matters and prepare themselves for the meeting. Once convened, the Board shall approve the agenda; should any member of the Board raise any objection to this agenda, the details of such objection shall be entered in the minutes of the meeting.
4. The Board shall document its meetings and prepare records of the deliberations and the voting, and arrange for these records to be kept in chapters for ease of reference.

Article 17: Remuneration and Indemnification of Board Members

The Articles of Association of the company shall set forth the manner of remunerating the Board members; such remuneration may take the form of a

lump sum amount, attendance allowance, rights *in rem* or a certain percentage of the profits. Any two or more of these privileges may be conjoined.

Article 18. Conflict of Interest within the Board

- a) A Board member shall not, without a prior authorization from the General Assembly, to be renewed each year, have any interest (whether directly or indirectly) in the company's business and contracts. The activities to be performed through general bidding shall constitute an exception where a Board member is the best bidder. A Board member shall notify the Board of Directors of any personal interest he/she may have in the business and contracts that are completed for the company's account. Such notification shall be entered in the minutes of the meeting. A Board member who is an interested party shall not be entitled to vote on the resolution to be adopted in this regard neither in the General Assembly nor in the Board of Directors. The Chairman of the Board of Directors shall notify the General Assembly, when convened, of the activities and contracts in respect of which a Board member may have a personal interest and shall attach to such notification a special report prepared by the company's auditor.
- b) A Board member shall not, without a prior authorization of the General Assembly, to be renewed annually, participate in any activity which may likely compete with the activities of the company, or trade in any branch of the activities carried out by the company.
- c) The company shall not grant cash loan whatsoever to any of its Board members or render guarantee in respect of any loan entered into by a Board member with third parties, excluding banks and other fiduciary companies.

PART 5
CLOSING PROVISIONS

Article 19: Publication and Entry into Force

These regulations shall be effective upon the date of their publication.

Appendix G: The Recent Corporate Governance Code 2017

KINGDOM OF SAUDI ARABIA

Capital Market Authority

Corporate Governance Regulations

English Translation of the Official Arabic Text

**Issued by the Board of the Capital Market Authority
Pursuant to Resolution Number (8-16-2017)
Dated 16/5/1438H Corresponding to 13/2/2017G
Based on the Companies Law
Issued by Royal Decree No M/3 dated 28/1/1437H**

**Amended by Resolution of the Board
of the Capital Market Authority Number 3-57-2019
Dated 15/9/1440H Corresponding to 20/5/2019G**

Note: Arabic is the official language of the Capital Market Authority

Important Notice: the current version of these Regulations, as may be amended, can be found at

The Authority website: www.cma.org.sa

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Part 1: Preliminary Provisions

Article 1: Definitions

The following terms and expressions shall have the meaning they bear as follows unless the contrary intention appears:

Companies Law: the Companies Law issued by Royal Decree No. (M/3) dated 28/1/1437 AH.

Capital Market Law: the Capital Market Law issued by Royal Decree No. (M/30) dated 2/6/1424 AH.

Rules on the Offer of Securities and Continuing Obligations: The Rules on the Offer of Securities and Continuing Obligations issued by the Board.

Listing Rules: The Listing Rules approved by the Board.

Authority: the Capital Market Authority.

The Exchange: The Saudi Stock Exchange.

Company: the listed joint stock company.

Board: the company's Board of Directors.

Corporate Governance: rules to lead and guide the Company that includes mechanisms to regulate the various relationships between the Board, Executive Directors, shareholders and Stakeholders, by establishing rules and procedures to facilitate the decision making process and add transparency and credibility to it with the objective of protecting the rights of shareholders and Stakeholders and achieving fairness, competitiveness and transparency on the Exchange and the business environment.

Shareholders Assembly: an assembly consisting of the shareholders in the Company formed in accordance with the provisions of the Companies Law and the Company's bylaws.

Executive Director: a member of the Board who is a full time member of the executive management team of the Company and participates in its daily activities.

Non-Executive Director: a member of the Board who is not a full-time member of the management team of the Company and does not participate in its daily activities.

Independent Director: a non-executive member of the Board who enjoys complete independence in his/her position and decisions and none of the independence affecting issues stipulated in Article 20 of these Regulations apply to him/her.

Executive Management or Senior Executive: persons responsible for managing the daily operations of the Company, and proposing and executing strategic decisions, such as the Chief Executive Officer (CEO) and his/her delegates and the Chief Financial Officer (CFO).

Relatives:

- Fathers, mothers, grandfathers and grandmothers (and their ancestors).
- children and grandchildren and their descendants.
- siblings, maternal and paternal half-siblings.
- Husbands and wives.

Holding Company: a Joint Stock Company or Limited Liability Company aims to control other Joint Stock Companies or Limited Liability Companies called affiliates by owning more than half of those companies' share capitals or by controlling the composition of their management.

Person: any natural or legal person that is recognised as such under the laws of the Kingdom.

Related Parties:

- A. Substantial Shareholders of the company.
- B. Board members of the Company or any of its affiliates and their relatives.
- C. Senior Executives of the Company or any of its affiliates and their relatives.
- D. Board members and Senior Executives of Substantial Shareholders of the company.
- E. Entities, other than companies, owned by a Board member or any Senior Executive or their relatives.
- F. Companies in which a Board member or a Senior Executive or any of their relatives is a partner.
- G. Companies in which a Board member or a Senior Executive or any of their relatives is a member of its Board of directors or is one of its Senior Executives.
- H. Joint stock companies in which a member of the Board or a Senior Executive or any of their relatives owns (5%) or more, subject to the provisions of paragraph (D) of this definition.
- I. Companies in which a Board member or a Senior Executive or any of their relatives has influence on their decisions even if only by giving advice or guidance.
- J. Any person whose advice or guidance influence the decisions of the Company, the Board and the Senior Executives.
- K. Holding companies or affiliates.

Advice or guidance that is provided on a professional basis by a person licensed to provide such advice shall be excluded from the provisions of paragraphs (I) and (J) of this definition.

The Group: When referring to a person, means the person and his affiliates.

Affiliate: a person who controls another person or is controlled by that other person, or who is under common control with that person by a third person. In any of the preceding, control could be direct or indirect.

Stakeholder: any person who has an interest in the Company, including employees, creditors, customers, suppliers and the community.

Substantial Shareholders: any person who owns (5%) or more of the shares of the Company or voting rights therein.

Cumulative voting: a method of voting for electing Board members that gives each shareholder a voting capacity equivalent to the number of shares he/she owns, and by which the shareholder is entitled to either exercise all of his/her votes towards one nominee or to divide his/her votes towards several nominees without any duplication of such votes.

Controlling Interest: The ability to influence actions or decisions of another person directly, indirectly, individually or collectively with a relative or an affiliate through: (A) owning %30 or more of the voting rights in a company, (B) having the right to appoint %30 or more of the administrative team members.

Administrative Team: A group of individuals who make strategic decisions of the person. The Board is the Company's Administrative Team.

Remunerations: amounts, allowances, dividends and the like, periodic or annual bonuses linked to performance, long or short term incentive plans and any other in-kind benefits except the actual reasonable expenses and fees incurred by the company to enable the Board member to perform his duties.

Day: Calendar day whether a business day or not.

Article 2: Preamble

- a) These Regulations state the rules and standards that regulate the management of the companies to ensure its compliance with the best governance practices that ensure the protection of shareholder's rights as well as the rights of Stakeholders.
- b) These Regulations are mandatory to companies except the provisions that contain a reference of being guiding.
- c) Without prejudice to the provisions of these Regulations, laws and instructions of other supervisory authorities apply to companies that subject to them.

Article 3: Objectives of the Regulations

These Regulations aim at establishing an effective legal framework to govern the Company, and particularly aim at the following:

- 1) enhancing the role of the Company's shareholders and facilitating the exercise of their rights;
- 2) Stating the competencies and responsibilities of the Board and the Executive Management;
- 3) enhancing the role of the Board and the committees and developing their capabilities to enhance the Company's decision making mechanisms;

Part 2: Rights of Shareholders

Chapter 1: General Rights

Article 4: Fair Treatment of Shareholders

- a) The Board is obliged to seek shareholders' rights protection to ensure fairness and equality among them.
- b) The Board and the Executive Management of the Company is obliged not to discriminate among shareholders who own the same class of shares nor prevent them from accessing any of their rights.
- c) The Company shall specify in its internal policies the procedures that are necessary to guarantee that all shareholders exercise their rights.

Article 5: Rights related to shares

All rights related to shares shall be guaranteed to the shareholder, and particularly the following:

- 1) to obtain his/her portion of the net profits which are to be distributed in cash or through the issuance of shares;
- 2) to obtain his/her share of the Company's assets upon liquidation;
- 3) to attend the General or Special Shareholders Assemblies, take part in their deliberations and vote on their decisions;
- 4) to dispose of his/her shares in accordance with the provisions of the Companies Law, The Capital Market Law and their implementing regulations ;
- 5) to enquire and request viewing the books and documents of the Company, including the data and information related to the activities of the Company and its operational and investment strategy without prejudice to the interests of the Company or breach of the Companies Law and the Capital Market Law and their implementing regulations;
- 6) to monitor the performance of the Company and the activities of the Board;
- 7) to hold Board members accountable, to file liability lawsuits against them and appeal for nullification of the resolutions of the General and Special Shareholders Assemblies in accordance with the conditions and restrictions provided in the Companies Law and the bylaws of the Company;
- 8) preemptive rights to subscribe for new shares issued in exchange for cash unless otherwise specified in the Company's bylaws or when the Extraordinary General Assembly suspends the pre-emptive rights as per Article (140) of the Company's Law.
- 9) to record his/her name in the Company's shareholders register;
- 10) to request to view a copy of the Company's articles of association and bylaws unless the Company publishes them on its website; and
- 11) to nominate and elect the Board members.

Article 6: Shareholder access to information

- a) The Board shall make available to the shareholder complete, clear, accurate and non-misleading information to enable him/her to properly exercise his/her rights. Such information shall be provided at the proper times and shall be updated regularly.
- b) The method used to provide information to the shareholders shall be clear and detailed and shall include a list of the Company's information that the shareholders may obtain. This information shall be made available to all shareholders of the same class.
- c) The Company shall use the most effective methods in communicating with shareholders and shall not discriminate among shareholders in respect of providing information.

Article 7: Communicating with Shareholders

- a) The Board shall ensure communication between the Company and the shareholders based on the common understanding of the strategic objectives and interests of the Company.
- b) The chairman of the Board and the Chief Executive Officer shall inform the remaining Board members of the opinions of the shareholders and discuss these opinions with them.
- c) No shareholder may intervene in the operations of the Board or the work of the Executive Management of the Company unless he/she is a member of its Board or its management team; or unless his/her intervention is through the Ordinary General Assembly according to its powers or within the limits and situations permitted by the Board.

Article 8: Electing the Board Members

- a) Upon calling for the General Assembly, the Company shall announce on the Exchange's website information about the nominees for the membership of the Board which shall include the nominees' experience, qualifications, skills and their previous and current jobs and memberships. The Company shall make a copy of the mentioned information available in the Company's head office and its website.
- b) Cumulative voting shall be used in electing the Board, in which it is not allowed to use the voting right of a single share more than once.
- c) Voting in the General Assembly shall be confined to the Board nominees whose information has been announced as per paragraph (a) of this Article.

Article 9: Distribution of Dividends

- a) The Company's bylaws shall prescribe the percentage of the net profits to be distributed to the shareholders after setting aside the statutory reserve and the other reserves.
- b) The Board shall establish a clear policy for the distribution of dividends to achieve the interests of the shareholders and the Company as per the Company's bylaw.
- c) The shareholder is entitled to receive his/her share of dividends as per the decision of the General Assembly in respect of the distribution of dividends to shareholders or the Board resolution on distributing interim dividends. The resolution shall specify the record date and the distribution date provided that the resolution shall be executed as per the Regulatory Rules and Procedures issued pursuant to the Companies Law related to Listed Joint Stock Companies.

Part 3: The Board of Directors

Chapter 1: Formation of the Board

Article 16: Composition of the Board

The following shall be taken into consideration when composing the Board:

- 1) the number of its members shall be suitable for the size and nature of the Company's activities without prejudice to paragraph (a) of Article 17 of these Regulations.
- 2) the majority of the Board members shall be of Non-Executive Directors.
- 3) the number of Independent Directors shall not be less than two members or one-third of the Board members, whichever is greater.

Article 17: Appointment of the Board members Board

- a) The Company's bylaws shall specify the number of the Board members, provided that such number shall not be less than three and not more than eleven.
- b) The General Assembly shall elect the Board members for the term stated in the Company's bylaws, provided that such term shall not exceed three years. Board members may be re-elected, unless otherwise provided for in the Company's bylaws.
- c) A Board member shall not be a member of the Boards of Directors of more than five listed joint stock companies at the same time.
- d) The Company shall notify the Authority of the names of the Board members and description of their memberships within five business days from the commencement date of the Board term or from the date of their appointment, whichever is shorter, as well as any changes that may affect their membership within five business days from the occurrence of such changes.

Article 18: Conditions for the membership of the Board

A member of the Board is required to be professionally capable and has the required experience, knowledge, skill and independence, which enable him/her to perform his/her duties efficiently. He/she shall have the following qualifications in particular:

- 1) **Ability to lead:** He/she shall enjoy leadership skills which enable him/her to delegate powers in order to enhance performance and apply best practices in effective management and compliance with professional ethics and values.
- 2) **Competency:** He/she shall have the academic qualifications and proper professional and personal skills as well as an appropriate level of training and practical experience related to the current and future businesses of the Company and the knowledge of management, economics, accounting, law or governance, as well as the desire to learn and receive training.

- 3) **Ability to guide:** He/she shall have the technical, leadership, and administrative competencies as well as the ability to take prompt decisions, and understand technical requirements and developments related to the job. He/she shall also be able to provide strategic guidance and long-term planning and have a clear future vision.
- 4) **Financial knowledge:** He/she shall have the ability to read and understand financial statements and reports.
- 5) **Physical fitness:** He/she shall not suffer from any health issue that may hinder him/her from performing his/her duties and responsibilities.

The General Assembly shall take into account, when electing members to the Board, the recommendations of the nomination committee and the availability of the personal and professional capabilities required to perform their duties effectively pursuant to this Article.

Article 19: Termination of a Board Membership

- a) The Company's bylaws shall specify the manner by which membership of the Board may be terminated. At all times, the Ordinary General Assembly may dismiss all or any of the Board members, even if the Company's bylaws provides for otherwise, without prejudice to the dismissed member's right for compensation if the dismissal was on an unacceptable reason or at inappropriate time. The General Assembly may also, s per a recommendation of the Board, terminate the membership of the member who missed three consecutive meetings without a legitimate excuse.
- b) Upon the termination of the membership of a Board member by any termination method, the Company shall promptly notify the Authority and the Exchange and shall specify the reasons for such termination.
- c) If a member of the Board resigns and has comments on the performance of the Company, he/she shall submit a written statement explaining such comments to the chairman of the Board and such statement shall be presented to the Board members.

Article 20: Issues Affecting Independence

- a) An Independent Director shall be able to perform his/her duties, express his/her opinions and vote on decisions objectively with no bias in order to help the Board make correct decisions that contribute to achieving the interests of the Company.
- b) The Board shall annually evaluate the extent of the member's independence and ensure that there are no relationships or circumstances that affect or may affect his/her independence.
- c) By way of example, the following negate the independence requirement for an Independent Director:
 - 1) if he/she holds five percent or more of the shares of the Company or any other company within its group; or is a relative of who owns such percentage.
 - 2) if he/she is a representative of a legal person that holds five percent or more of the shares of the Company or any company within its group;
 - 3) if he/she is a relative of any member of the Board of the Company, or any other company within the Company's group;
 - 4) if he/she is a relative of any Senior Executive of the Company, or of any other company within the Company's group;

- 5) if he/she is a Board member of any company within the group of the Company for which he/she is nominated to be a Board member.
 - 6) if he/she is an employee or used to be an employee, during the preceding two years, of the Company, of any party dealing with the Company or any company within its group, such as external auditors or main suppliers; or if he/she, during the preceding two years, held a controlling interest in any such parties;
 - 7) if he/she has a direct or indirect interest in the businesses and contracts executed for the Company's account;
 - 8) if the member of the Board receives financial consideration from the Company in addition to the remuneration for his/her membership of the Board or any of its committees exceeding an amount of (SAR 200,000) or 50% of his/her remuneration of the last year for the membership of the board or any of its committees, whichever is less.
 - 9) if he/she engages in a business where he competes with the Company, or conducting businesses in any of the company's activities.
 - 10) if he/she served for more than nine years, consecutive or inconsecutive, as a Board member of the Company.²
- d) Unless the Nominations Committee considers otherwise, the businesses and contracts with the board member to meet his/her personal needs shall not be deemed as an interest that affect the independence of the board member which require an authorisation from the ordinary general assembly, provided that such businesses and contracts are carried out in the same conditions and settings followed by the company with all contractors and dealers, and that such businesses and contracts must be within the normal course of the Company's activities.

Chapter 2: Responsibilities and Competencies of the Board

Article 21: Responsibility of the Board

- a) The Board represents all shareholders; it shall perform its duties of care and loyalty in managing the Company's affairs and undertake all actions in the general interest of the Company and develop it and maximise its value.
- b) The Board is responsible for the Company's business even if it delegates some of its powers to committees, individuals or other third parties. In any case, the Board may not issue a general or an open-ended delegation.

Article 22: Main Functions of the Board

Without prejudice to the competencies of the General Assembly as per the Companies Law and Its Implementing Regulations and the Company's bylaws, the Board shall have the broadest powers in managing the Company and guiding its activities to achieve its objectives. Among the main functions and competencies of the Board are the following:

² The Capital Market Authority Board issued its Resolution Number 1-35-2018 Dated 9/7/1439H Corresponding to 26/3/2018G stating that the sub-paragraph (10) of paragraph (c) of Article 20 of the Corporate Governance Regulations is to be a mandatory paragraph starting from the term of the listed company's board that will be after 1/1/2019G.

- 1) laying down the plans, policies, strategies and main objectives of the Company; supervising their implementation and reviewing them periodically; . And, ensuring that the human and financial resources required to fulfill them are available, including:
 - a. setting a comprehensive strategy for the Company, key business plans and policies and mechanisms of the risk management and review and guide them
 - b. determining the most appropriate capital structure for the Company, its strategies and financial objectives, and approving all kinds of estimated budgets;
 - c. overseeing the main capital expenditures of the Company and the acquisition or disposal of assets;
 - d. setting performance indicators, and monitoring the implementation thereof and the overall performance of the Company;
 - e. reviewing and approving the organisational and human resources structures of the Company on a periodic basis; and
 - f. ensuring that the financial and human resources required for achieving the objectives and main plans of the Company are available.
- 2) setting rules and procedures for internal control and generally overseeing them, including:
 - a. developing a written policy to remedy actual and potential conflicts of interest scenarios for each of the Board members, the Executive Management, and the shareholders. This includes misuse of the Company's assets and facilities and the mismanagement resulting from transactions with Related Parties;
 - b. ensuring the integrity of the financial and accounting rules, including rules relating to the preparation of financial reports;
 - c. ensuring the implementation of appropriate control procedures for risk assessment and management by generally forecasting the risks that the Company may encounter and creating an environment which is aware of the culture of risk management at the Company level and disclosing such risks transparently to the Stakeholders and parties related to the Company ; and
 - d. reviewing the effectiveness of the Company's internal control procedures on an annual basis.
- 3) setting forth specific and explicit policies, standards and procedures for membership in the Board, without prejudice to the mandatory provisions of these Regulations, and implementing them following approval by the General Assembly;
- 4) developing a written policy that regulates the relationship with Stakeholders pursuant to the provisions of these Regulations;
- 5) setting policies and procedures to ensure the Company's compliance with the laws and regulations and the Company's obligation to disclose material information to shareholders and Stakeholders, and ensuring the compliance of the Executive Management with these policies and procedures;
- 6) supervising the management of the Company's finances, its cash flows as well as its financial and credit relationships with third parties;
- 7) providing recommendations to the Extraordinary General Assembly as to what it deems appropriate regarding the following:
 - a. increasing or decreasing the share capital of the Company; and
 - b. dissolving the Company before the end of its term as specified in its bylaws or deciding the continuity of the Company.

- 8) providing recommendation to the Ordinary General Assembly as to what it deems appropriate regarding:
 - a. using the consensual reserve of the Company, if such has been formed by the Extraordinary General Assembly and has not been allocated to a specific purpose;
 - b. forming additional financial allocations or reserves for the Company; and
 - c. the method of distributing the net profits of the Company.
- 9) preparing the Company's interim and annual financial statements and approving them before publishing them;
- 10) preparing the Board report and approving it before publishing it.
- 11) ensuring the accuracy and integrity of the data and information which must be disclosed pursuant to the applicable policies and systems in respect of disclosure and transparency;
- 12) developing effective communication channels allowing shareholders to continuously and periodically review the various aspects of the Company's businesses as well as any material developments;
- 13) forming specialised committees of the Board pursuant to resolutions that shall specify the term, powers and responsibilities of such committees as well as the manner used by the Board to monitor such committees. Such resolutions shall also specify the names of the members and their duties, rights and obligations and shall evaluate the performance and activities of these committees and their members;
- 14) specifying the types of remunerations granted to the Company's employees, such as fixed remunerations, remunerations linked to performance and remunerations in the form of shares without prejudice to the Regulatory Rules and Procedures issued pursuant to the Companies Law related to Listed Joint Stock Companies;
- 15) setting the values and standards that govern the work at the Company;

Article 23: Distribution of Competencies and Duties

The organisational structure of the Company shall specify the competencies and distribute the duties between the Board and the Executive Management in accordance with the best practices in Corporate Governance, and to improve the efficiency of the Company's decision making and to achieve a balance of powers and authorities across the Board and the Executive Management, and to achieve this, the Board shall:

- 1) approve and develop internal policies in respect of the Company's business, including specifying the duties, competencies and responsibilities assigned to the various organisational levels;
- 2) approving a written and detailed policy that identifies the powers delegated to the Executive Management, a matrix stating these powers, means of implementation and the period of delegation\ The Board may request the Executive Management to submit periodic reports in respect of its exercise of such delegated powers; and
- 3) identifying the matters on which the Board reserves the power to decide.

Article 24: Separation of Positions

- a) without prejudice to the provisions of the Company's bylaws, The Board appoints a chairman, a vice chairman and may appoint a managing director of its members.

- b) it is prohibited to hold, at the same time, the position of chairman of the Board and any other executive position in the Company, including the positions of the managing director, the Chief Executive Officer, or the general manager, even if the Company's bylaws provided for otherwise.
- c) the Board shall define the competencies and specify the responsibilities of the chairman, the vice chairman, and the managing director (if any) explicitly and in writing if the Company's bylaws has no reference thereto.
- d) in all cases, no person shall have the sole and absolute power to take decisions in the Company.

Article 25: Oversight over the Executive Management

The Board shall form the Executive Management of the Company, regulate its operating procedures, monitor and oversee it and ensure that it performs the duties assigned to it, and to achieve this, the Board shall:

- 1) develop the necessary administrative and financial policies;
- 2) ensure that the Executive Management operates in accordance with the policies approved by the Board.;
- 3) select and appoint the Chief Executive Officer of the Company, and oversee his/her work;
- 4) appoint the manager of the internal audit unit or department, or the internal auditor and dismiss him and determine his remuneration, if any;
- 5) convene periodic meetings with the Executive Management to explore the work progress and any obstacles and problems in connection therewith, and review and discuss the important information in respect of the Company's business;
- 6) develop standards for the performance of the Executive Management consistent with the objectives and strategy of the Company;
- 7) review and evaluate the performance of the Executive Management; and
- 8) develop succession plans for the management of the Company.

Article 26: Competencies and Duties of the Executive Management

Without prejudice to the competencies entrusted to the Board pursuant to the provisions of the Companies Law and Its Implementing Regulations, the Executive Management shall be responsible for implementing the plans, policies, strategies and main objectives of the Company in order to achieve its purposes. The competencies and duties of the Executive Management shall include the following:

- 1) implementing the Company's internal policies and rules approved by the Board;
- 2) suggesting the Company's comprehensive strategy as well as the principal and interim business plans and the policies and mechanisms for investment, financing, risk management and emergency administrative circumstances management plans and implementing them;
- 3) proposing the most appropriate capital structure for the Company and its strategies and financial objectives;
- 4) proposing the main capital expenditures of the Company and acquiring and disposing of assets;

- 5) proposing the organisational and human resources structures of the company and presenting them to the Board for approval;
- 6) implementing internal control systems and procedures, and generally overseeing them, which include:
 - a. implementing the conflicts of interest policy;
 - b. correctly applying the financial and accounting procedures, including the procedures relating to the preparation of financial reports;
 - c. applying appropriate control systems for measuring and managing risks by generally forecasting the risks that the Company may encounter and creating an environment which is aware of the culture of risk mitigation at the Company level, and transparently disclosing them to the Company's Board and other Stakeholders.
- 7) implementing the Company's Corporate Governance rules effectively, to the extent they do not conflict with the provisions of these Regulations, and proposing amendments thereto if needed;
- 8) implementing policies and procedures to ensure the Company's compliance with the laws and regulations and its obligation to disclose material information to shareholders and Stakeholders;
- 9) providing the Board with the information required to exercise its competencies and provide recommendations regarding the following:
 - a. increasing or decreasing the share capital of the Company;
 - b. dissolving the Company before the end of its term as specified in its bylaws or deciding the continuity of the Company;
 - c. using the consensual reserve of the Company;
 - d. forming additional reserves for the Company; and
 - e. the method for distributing the net profits of the Company.
- 10) proposing the policy and types of remunerations granted to employees, such as fixed remunerations, remunerations linked to performance and remunerations in the form of shares;
- 11) preparing periodic financial and non-financial reports in respect of the progress achieved in the business of the Company in light of the strategic plans and objectives of the Company, and presenting such reports to the Board;
- 12) managing the daily business and activity of the Company, in addition to managing its resources in the most appropriate form in accordance with the objectives and strategies of the Company;
- 13) participating effectively in building and developing a culture of ethical values within the Company;
- 14) implementing internal control and risk management systems and ensuring that they are effective and efficient, and ensuring compliance with the level of risks approved by the Board;
- 15) proposing and developing internal policies related to the business of the Company, including specifying the duties, competencies and responsibilities assigned to the various organisational levels;
- 16) proposing a clear policy to delegate tasks to the Executive Management and the method for implementing such policy; and

- 17) proposing the powers to be delegated to the Executive Management, the procedures for decision making and the period of delegation, provided that it shall present periodic reports to the Board in respect of its exercise of such powers.

Chapter 3: Competencies of the Chairman and the Board Members

Article 27: Competencies and Duties of the Chairman of the Board

Without prejudice to the competencies of the Board, the chairman of the Board shall be responsible for leading the Board and supervising its operations and the effective performance of its duties. The competencies and duties of the chairman of the Board shall in particular include the following:

- 1) ensuring that the Board members obtain complete, clear, accurate and non-misleading information in due course;
- 2) ensuring that the Board effectively discusses all fundamental issues in due course;
- 3) representing the Company before third parties in accordance with the Companies Law and Its Implementing Regulations and the Company's bylaws;
- 4) encouraging the Board members to effectively perform their duties in order to achieve the interests of the Company;
- 5) ensuring that there are actual communication channels with shareholders and conveying their opinions to the Board;
- 6) encouraging constructive relationships and effective participation between the Board and the Executive Management on the one hand, and the Executive, Non-Executive and Independent Directors on the other hand, and creating a culture that encourages constructive criticism;
- 7) preparing agendas of the Board meetings, taking into consideration any matters raised by Board members or the external auditor and consult with the Board members and the Chief Executive Officer upon preparing the Board's agenda; and
- 8) convening periodic meetings with the Non-Executive Directors without the presence of any executive officers of the Company.
- 9) notifying the Ordinary General Assembly while convening of the businesses and contracts in which any Board member has direct or indirect interest, the notification shall include the information provided by the member to the Board as per paragraph (14) of Article (30) of these Regulations; this notification shall be accompanied by a special report of the Company's external auditor.

Article 28: Appointing the Chief Executive Officer after the end of his/her services as Chairman of the Board

It is prohibited to appoint the Chief Executive Officer, during the first year following the end of his/her service, as the chairman of the Board.

Article 29: Principles of truthfulness, honesty and loyalty

³ The Capital Market Authority Board issued its Resolution Number 4-52-2018 Dated 28/8/1439H Corresponding to 14/5/2018G stating that Article 28 of the Corporate Governance Regulations is to be Guiding Article.

Each member of the Board shall comply with the principles of truthfulness, honesty, loyalty, and care of the interests of the Company and its shareholders, and prioritise their interests over his/her personal interests. This shall include, in particular, the following:

- 1) **Truthfulness:** is achieved when the relationship between the Board member and the Company is an honest professional relationship, and he/she discloses to the Company any significant information before entering into any transaction or contract with the Company or any of its affiliates.
- 2) **Loyalty:** is achieved when the Board member avoids transactions that may entail conflicts of interest and ensures fairness of dealing, in compliance with the provisions relating to conflicts of interest in these Regulations.
- 3) **Care:** is achieved by performing the duties and responsibilities set forth in the Companies Law, the Capital Market Law and their implementing regulations and the Company's bylaws and other relevant laws.

Article 30: Tasks and Duties of the Board Members

Each member of the Board shall, being a Board member, perform the following tasks and duties:

- 1) providing proposals to develop the strategy of the Company;
- 2) monitoring the performance of the Executive Management and the extent to which it has achieved the objectives and purposes of the Company;
- 3) reviewing reports related to the performance of the Company;
- 4) ensuring the integrity and impartiality of the financial statements and information of the Company;
- 5) ensuring that the financial control and risk management systems are sound;
- 6) determining the appropriate level of remunerations of the members of the Executive Management;
- 7) expressing opinions as to the appointment and dismissal of members of the Executive Management;
- 8) participating in developing the succession and replacement plans of executive positions within the Company;
- 9) complying fully with the provisions of the Companies Law, Capital Market Law, their implementing regulations, the relevant regulations and the bylaws when performing his/her duties as a member of the Board and abstaining from taking or participating in any action that constitute mismanagement of the Company's affairs;
- 10) attending the Board and the General Assembly meetings, and not being absent except for legitimate excuse of which the chairman of the Board shall be notified by prior notice, or for emergency reasons;
- 11) allocating sufficient time to fulfill his/her responsibilities and preparing for the Board and its committees meetings and effectively participating therein, including raising relevant questions and carrying discussions with the Senior Executives;
- 12) studying and analysing all information related to the matters looked into by the Board before expressing an opinion on the same;
- 13) enabling other Board members to express their opinions freely, and encouraging the Board to deliberate on the subjects and obtain the views of the competent members of the Company's Executive Management and others, when necessary;

- 14) notifying the Board fully and immediately of any interest, either direct or indirect, in the businesses and contracts that are executed for the Company's account, the notification shall include the nature and extent of such interest, the names of concerned persons, and the expected benefit to be obtained directly or indirectly from interest whether financial or non-financial. the concerned member shall abstain from voting on any decisions issued in connection therewith in compliance with the provisions of the Companies Law, the Capital Market Law and their implementing regulations;
- 15) notifying the Board fully and immediately of his/her participation, directly or indirectly, in any businesses that may compete with the Company or lead to competing with the Company, directly or indirectly, in respect of any of its activities, in compliance with the provisions of the Companies Law, the Capital Market Law and their implementing regulations;
- 16) refraining from disclosing or announcing any secrets he/she came across through his/her membership in the Board to any shareholder of the Company, unless such disclosure is made during the meetings of the General Assembly, or to a third party, in pursuance with the provisions of the Companies Law, the Capital Market Law and their implementing regulations;
- 17) working on the basis of complete information, in good faith and with the necessary care and diligence for the interest of the Company and all shareholders;
- 18) recognising his/her duties, roles and responsibilities arising from the membership;
- 19) developing his/her knowledge in the field of the Company's business and activities and in the related financial, commercial and industrial fields; and
- 20) resigning from the membership of the Board if he/she is unable to fully fulfill his/her duties in the Board.

Article 31: Duties of the Independent Director

Without prejudice to Article (30) of these Regulations, an Independent Director of the Board shall effectively participate in the following duties:

- 1) expressing his/her independent opinion in respect of strategic issues and the Company's policies and performance and appointing members of the Executive Management;
- 2) ensuring that the interest of the Company and its shareholders are taken into account and given priority in case of any conflicts of interest;
- 3) overseeing the development of the Company's Corporate Governance rules, and monitoring the implementation of the rules by the Executive Management.

Chapter 4: Procedures of the Board Activities

Article 32: The Board Meetings

- a) Without prejudice to the Companies Law and Its Implementing Regulations, the Board shall convene regular meetings to perform its duties effectively, and also convene meetings whenever needed.

- b) The Board shall convene no less than four meetings per year, and no less than one meeting every three months.⁴
- c) The Board shall meet upon the invitation of its chairman or upon a request from two of its members. The invitation to the meeting shall be sent to each of the Board members no less than five days prior to the date of the meeting accompanied by its agenda and the necessary documents and information, unless circumstance require convening an emergency meeting, the invitation accompanied with the agenda and necessary documents and information may be sent within a period less than the five days.
- d) The meeting shall not be valid unless attended by half of the Board members, provided that the number of attendees shall not be less than three, unless the Company's bylaws stated greater percentage or number.

Article 33: Remarks of the Board Members

- a) If any member of the Board has any remarks in respect of the performance of the Company or any of the matters presented and which was not resolved in the Board meeting, such remarks shall be recorded and the procedures taken or to be taken by the Board in connection therewith must be set forth in the minutes of the Board meeting.
- b) If a member of the Board expresses an opinion differs from the Board resolution, such opinion must be recorded in detail in the minutes of the Board meeting.

Article 34: Organising the Attendance of the Board Meetings.

- a) The Attendance of Board meetings, and dealing with cases of irregular attendance by members of such meetings shall be organised.
- b) An Independent Director of the Board shall make every effort to attend all meetings in which important and material decisions affecting the position of the Company are made.

Article 35: The Agenda of Board Meetings

- a) The Board shall approve the agenda once the Board meeting is convened. Should any member of the Board raise any objection in respect of such agenda, such objection shall be recorded in the minutes of the meeting.
- b) Each member of the Board is entitled to propose additional items to the agenda.

Article 36: Exercising the Competencies of the Board

- a) The Board shall exercise its competencies and duties to lead the Company within a framework of effective and prudent controls that allow assessing and managing risks and limiting and mitigating their effects.
- b) Without prejudice to Paragraph (b) of Article (21) of these Regulations, the Board may, within the scope of its competencies, delegate to one or more of its members or committees or a third party the performance of a specific function or functions.

⁴ Guiding paragraph

- c) The Board shall develop an internal policy that explains the procedures of the Board activities and aims at encouraging its members to work effectively to fulfill their obligations towards the Company.
- d) The Board shall organise its activities and allocate sufficient time to perform the duties and responsibilities assigned to it, including preparing for Board and committees meetings and ensuring the coordination, recording and retaining of the minutes of its meetings.

Article 37: The Secretary of the Board

- a) The Board shall appoint a secretary among its members or a third party, whose competencies and remunerations shall be specified by a Board resolution, unless the Company's bylaws include provisions in connection therewith, provided that such powers shall include:
 - 1) documenting the Board meetings and preparing minutes therefor, which shall include the discussions and deliberations carried during such meetings, as well as the place, date, times on which such meetings commenced and concluded; and recording the decisions of the Board and voting results and retaining them in a special and organised register, and including the names of the attendees and any reservations they expressed (if any),. Such minutes shall be signed by all of the attending members;
 - 2) retaining the reports submitted to the Board and the reports prepared by it;
 - 3) providing the Board members with the agenda of the Board meeting and related worksheets, documents and information and any additional information, related to the topics included in the agenda items, requested by any Board member;
 - 4) ensuring that the Board members comply with the procedures approved by the Board;
 - 5) notifying the Board members of the dates of the Board’s meetings within sufficient time prior to the date specified for the meeting;
 - 6) presenting the draft minutes to the Board members to provide their opinions on them before signing the same;
 - 7) ensuring that the Board members receive, fully and promptly, a copy the minutes of the Board’s meetings as well as the information and documents related to the Company;
 - 8) coordinating among the Board members;
 - 9) regulating the disclosure register of the Board and Executive Management as per Article (92) of these Regulations; and
 - 10) providing assistance and advice to the Board members.
- b) The Secretary of the Board may not be dismissed except pursuant to a decision of the Board.

Article 38: Qualifications of the Secretarys

The Board must specify the conditions that the secretary must meet, provided that they include at least one of the following:

- 1) he/she holds a bachelor degree in law, finance, accounting or administration or their equivalent, and has relevant practical experience of not less than three years; or
- 2) he/she has relevant practical experience of not less than five years.

Chapter 5: Training, Support and Assessment

Article 39: Training ⁶

The Company shall pay adequate attention to the training and preparation of the Board members and the Executive Management, and shall develop the necessary programmes required for the same, taking the following into account:

- 1) preparing programmes for the recently-appointed Board members and Executive Management to familiarise them with the progress of the Company's business and activities, particularly the following:
 - a. the strategy and objectives of the Company;
 - b. the financial and operational aspects of the Company's activities;
 - c. the obligations of the Board members and their duties, responsibilities and rights;
 - d. the duties and competencies of the committees of the Board.
- 2) developing the necessary mechanisms for Board members and the Executive Management to continuously enroll in training programmes and courses in order to develop their skills and knowledge in the fields related to the activities of the Company.

Article 40: Providing Members with Information

The Executive Management of the Company shall provide the Board members, the Non-Executive Directors in particular, and the committees of the Company with all of the necessary information, details, documents and records, provided that they shall be complete, clear, correct and non-misleading, in due course to enable them to perform their duties and obligations.

Article 41: The Assessment⁷

- a) The Board shall develop, based on the proposal of the nomination committee, the necessary mechanisms to annually assess the performance of the Board, its members and committees and the Executive Management using key performance indicators linked to the extent to which the strategic objectives of the Company have been achieved, the quality of the risk management and the efficiency of the internal control systems, among others, provided that weaknesses and strengths shall be identified and a solution shall be proposed for the same in the best interests of the Company.
- b) The procedures of performance assessment shall be in writing and clearly stated and disclosed to the Board members and parties concerned with the assessment.

⁶ Guiding Article

⁷ Guiding Article

- a) When nominating a Board member, the nomination committee shall take into consideration the provisions of these Regulations and the requirements set by the Authorities; and
- b) The number of nominees to the Board whose names are presented to the General Assembly shall be more than the number of available seats to give a chance to the General Assembly to select the Board members among those nominees.⁹

Article 67: Meetings of the Nomination Committee

The nomination committee shall convene periodically at least once a year, and as may be necessary.

Article 68: Publishing the Nomination Announcement

The Company shall publish the nomination announcement on the websites of the Company and the Exchange and through any other medium specified by the Authority; to invite persons wishing to be nominated to the membership of the Board, provided that the nomination period shall remain open for at least a month from the date of the announcement.

Article 69: Nomination Rights of Shareholders

None of the provisions of this Chapter shall prejudice the right of any shareholder to nominate him/herself or others to the membership of the Board in accordance with the provisions of the Companies Law and Its Implementing Regulations.

Chapter 5: Risk Management Committee

Article 70: Composition of the Risk Management Committee¹⁰

The Company's Board shall, by resolution therefrom, form a committee to be named the "risk management committee." Chairman and majority of its members shall be Non-Executive Directors. The members of that committee shall possess an adequate level of knowledge in risk management and finance.

Article 71: Competencies of the Risk Management Committee¹¹

The competences of the risk management committee shall include the following:

- 1) developing a strategy and comprehensive policies for risk management that are consistent with the nature and volume of the Company's activities, monitoring their implementation, and reviewing and updating them based on the Company's internal and external changing factors;
- 2) determining and maintaining an acceptable level of risk that may be faced by the Company and ensuring that the Company does not go beyond such level;

⁹ Guiding paragraph

¹⁰ Guiding Article

¹¹ Guiding Article

- 3) Ensuring the feasibility of the Company continuation, the successful continuity of its activities and determining the risks that threaten its existence during the following twelve (12) months;
- 4) overseeing the Company's risk management system and assessing the effectiveness of the systems and mechanisms for determining and monitoring the risks that threaten the Company in order to determine areas of inadequacy therein;
- 5) Regularly reassessing the Company's ability to take risks and be exposed to such risks (through stress tests as an example);
- 6) preparing detailed reports on the exposure to risks and the recommended measures to manage such risks, and presenting them to the Board;
- 7) providing recommendations to the Board on matters related to risk management;
- 8) ensuring the availability of adequate resources and systems for risk management;
- 9) reviewing the organisational structure for risk management and providing recommendations regarding the same before approval by the Board;
- 10) verifying the independence of the risk management employees from activities that may expose the Company to risk;
- 11) ensuring that the risk management employees understand the risks threatening the Company and seeking to raise awareness of the culture of risk; and
- 12) reviewing any issues raised by the audit committee that may affect the Company's risk management.

Article 72: Meetings of the Risk Management Committee¹²

The risk management committee shall convene periodically at least once every six months, and as may be necessary.

PART 5: Internal Control

Article 73: Internal Control System

The Board shall approve an internal control system for the Company in order to assess the policies and procedures relating to risk management, implementation of the provisions of the Company's governance rules approved by the Company and compliance with the relevant laws and regulations. Such system shall ensure compliance with clear accountability

¹² Guiding Article

Article 80: Assigning the Audit Function

The Company shall assign the function of auditing its annual accounts to an independent and competent external auditor who possesses the necessary expertise and qualifications to prepare an objective and independent report to the Board and the shareholders, setting out whether the Company's financial statements clearly and impartially express the financial position of the Company and its performance in the significant areas.

Article 81: Appointment of the External Auditor

The Ordinary General Assembly shall appoint the Company's external auditor based on a recommendation from the Board, provided that the following requirements are met:

- 1) the nomination shall be based on a recommendation from the audit committee;
- 2) the external auditor shall be authorised by the Competent Authority;
- 3) the external auditor's interests shall not conflict with the interests of the Company; and
- 4) the number of nominees shall not be less than two.

Article 82: Duties of the External Auditor

The external auditor shall:

- 1) owe the duties of loyalty and care to the Company;
- 2) notify the Authority if the Board fails to take appropriate actions in respect of suspicious issues it raises; and
- 3) Request the Board to call for a General Assembly meeting if the Board has not facilitated his mission; and shall be liable to compensate the Company, the shareholders or third parties for the damages resulted from errors it commits in the course of its engagement. If an error is attributable to more than one external auditor, they shall be jointly responsible therefor.

PART 7: Stakeholders

Article 83: Regulating the Relationship with Stakeholders¹⁶

The Board shall establish clear and written policies and procedures regulating the relationship with Stakeholders with the aim of protecting them and safeguard their rights, which shall include the following, in particular:

- 1) methods to compensate Stakeholders when their rights established by laws or protected by contracts are infringed;

¹⁶ Guiding Article

- 2) methods for resolving complaints or disputes that may arise between the Company and the Stakeholders;
- 3) methods for building good relationships with customers and suppliers and maintaining the confidentiality of their information;
- 4) rules of professional conduct for Company managers and employees that are prepared in compliance with the proper professional and ethical standards and regulate their relationship with Stakeholders, provided that the Board shall establish mechanisms for supervising the implementation of, and compliance with such rules;
- 5) the Company's social contributions;
- 6) ensuring that the Company's transactions with Board members and Related Parties are entered into on terms identical to the terms of transactions with Stakeholders without any discrimination or bias;
- 7) Stakeholders obtaining of information relevant to their activities to enable them to perform their duties. Such information shall be correct and sufficient and shall be provided in timely manner and on a regular basis; and
- 8) treating Company employees pursuant to the principles of justice and equality and without discrimination.

Article 84: Reporting Non-Compliant Practices

The Board shall, based upon a proposal from the audit committee, develop the necessary policies and procedures to be followed by Stakeholders when submitting complaints or reporting any violations, taking the following into consideration:

- 1) facilitating the method by which Stakeholders (including Company employees) report to the Board conducts and practices of the Executive Management's that violate applicable laws, regulations and rules or raising doubts as to the financial statements or the internal audit controls or others, whether such conducts or practices are against them or not, and conducting the necessary investigation in that regard;
- 2) maintaining the confidentiality of reporting procedures through facilitating direct contact with an independent member of the audit committee or other specialised committees;
- 3) appointing an employee to receive and address complaints or reports sent by Stakeholders;
- 4) dedicating a telephone number or an email address for receiving complaints; and
- 5) providing the necessary protection to the Stakeholders.

Article 85: Employee Incentives¹⁷

The Company shall establish programmes for developing and encouraging the participation and performance of the Company's employees. The programmes shall particularly include the following:

- 1) forming committees or holding specialised workshops to hear the opinions of the Company's employees and discuss the issues and topics that are subject to important decisions;
- 2) establishing a scheme for granting Company shares or a percentage of the Company profits and pension programmes for employees, and setting up an independent fund for such programme; and

¹⁷ Guiding Article

- 1) establishing indicators that link the Company's performance with its social initiatives and comparing it with other companies that engage in similar activities;
- 2) disclosing the objectives of the Company's social responsibility to its employees and raising their awareness and knowledge of social responsibility;
- 3) disclosing plans for achieving social responsibility in the periodical reports on the activities of the Company's; and
- 4) establishing awareness programmes to the community to familiarise them with the Company's social responsibility.

PART 9: Disclosure and Transparency

Article 89: Policies and Procedure of Disclosure

Without prejudice to the Rules on the Offer of Securities and Continuing Obligations and the Listing Rules, the Board shall set forth in writing the policies, procedures and supervisory rules related to disclosure pursuant to the disclosure requirements provided for in the Companies Law and the Capital Market Law, as the case may be, and their implementing regulations, taking into consideration the following:

- 1) such policies shall include proper disclosure methods that enable the shareholders and other Stakeholders to access the financial and non-financial information pertaining to the Company's performance and information in respect of ownership of shares, and to obtain a comprehensive view of the Company's position;
- 2) disclosure to shareholders and investors shall be made without discrimination in a clear, correct and non-misleading fashion, and in a timely, regular and accurate manner in order to enable shareholders and other Stakeholders to exercise their rights to the fullest extent;
- 3) the Company's website shall include all information required to be disclosed and any details or other information that may be published through other disclosure methods;²⁰
- 4) reporting rules shall be established and shall describe the information required to be disclosed and the method of its classification in terms of its nature, and the frequency of its disclosure; and
- 5) the disclosure policies shall be reviewed periodically and their compliance with the best practices and the provisions of the Capital Market Law and its implementing rules shall be verified.

Article 90: The Board's Report

The Board's report shall include the Board's operations during the last fiscal year and all factors that affect the company's businesses , such report shall include the following:

- 1) implemented and non-implemented provisions of these Regulations, and justifications therefor;
- 2) names, qualifications, and experience of the Board and committees members and Executive Management;

²⁰ Guiding paragraph

- 3) names of the companies inside and outside the Kingdom in which a Board member is a member of their current or previous Board member or manager;
- 4) composition of the Board and classification of its members, as follows: Executive Directors, Non-Executive Director, or Independent Director;
- 5) Procedure taken to the Board to inform its members , Non-Executive Directors in particular, of the shareholders' suggestions and remarks on the Company and its performance.
- 6) a brief description of the competencies and duties of the committees, such as the audit committee, the nomination committee and the remuneration committee indicating their names, names of their chairmen, names of their members, the number of their respective meetings, dates of those meetings and the members' attendance details of each meeting;
- 7) Where applicable, the means used by the Board to assess its performance, the performance of its committees and members and the external body which conducted the assessment and its relation with the Company, if any;
- 8) disclose the remuneration of the Board members and Executive Management as stated in Article (93) of these Regulations;
- 9) any punishment, penalty, precautionary procedure or preventive measure imposed on the Company by the Authority or any other supervisory, regulatory or judiciary authority, describing the reasons for non-compliance, the imposing authority and the measures undertaken to remedy and avoid such non-compliance in the future;
- 10) results of the annual review of the effectiveness of the internal control procedures of the Company and the opinion of the audit committee with respect to the adequacy of the Company's internal control system;
- 11) the audit committees recommendation on the need for appointing an internal auditor for the Company, if there is no internal auditor.
- 12) the audit committees recommendation with conflict with Board resolution or those which the Board disregards relating to the appointment, dismissal, assessment or determining the remuneration of an external auditor, as well as justifications for those recommendations and reasons for disregarding them.
- 13) details of the Company's social contributions, if any;
- 14) a list of the dates of the General Assembly meetings held during the last fiscal year and the names of the Board members who attended them.
- 15) a description of the main scope of business of the company and its affiliates. If there are two or more, a statement showing each activity and how it affects the company businesses and results shall be attached.
- 16) a description of the company's significant plans and decisions (including changes to the structure, expanding the company's operations or halting them) and the future expectations.
- 17) information on any risks facing the company (operational, financial or market related) and the policy of managing and monitoring these risks.
- 18) a summary in a form of table or graph showing the company's assets, liabilities and results of the last five fiscal year or since the incorporation date, whichever is shorter.
- 19) geographical analysis of the company's and its affiliates' revenues.
- 20) any material differences in the operational results compared to the preceding year's results, along with any expectations announced by the company.
- 21) any inconsistency with the standards approved by the Saudi Organisations for Certified Public Accountant.

- 22) name of each affiliate company, its capital, the company's ownership percentage, the main scope of business, country of operation and country of incorporation.
- 23) details of shares and debt instruments issued for each affiliate company.
- 24) a descriptions of the dividends distribution policy.
- 25) a description of any interest in a class of voting shares held by persons (other than the company's directors, Senior Executives and their relatives) who have notified the company of their holdings pursuant to Article 68 of the Rules on the Offer of Securities and Continuing Obligations, together with any change to such interests during the last fiscal year;
- 26) a description of any interest, contractual securities or rights issue of the Board members, Senior Executives and their relatives on shares or debt instruments of the company or its affiliates, and any change on these interest or rights during the last fiscal year.
- 27) information on any loans (payable upon request or not), a statement of the total indebtedness of the company and its affiliates, any amounts paid by the company in repayments of loans during the year, the amount of the principal debts, the creditor name, the loan term and remaining amount. In case there is no debts, a declaration thereof shall be presented.
- 28) a description of the class and number of any convertible debt instruments, contractual securities, preemptive right or similar rights issued or granted by the company during the fiscal year, as well as stating any compensation obtained by the company in this regard.
- 29) a description of any conversion or subscription rights under any convertible debt instruments, contractually based securities, warrants or similar rights issued or granted by the company;.
- 30) description of any redemption, purchase or cancellation by the company of any redeemable debt instruments and the value of such securities outstanding, distinguishing between those listed securities purchased by the company and those purchased by its affiliates.
- 31) the number of Board meetings held during the last financial year, their dates and the attendance record of each meeting listing the names of the attendees.
- 32) numbers of company's requests of shareholders records, dates and reasons thereof.
- 33) a description of any transaction between the company and any Related Party.
- 34) information relating to any business or contract to which the company is a party and in which a director of the company, a Senior Executive or any person related to any of them is or was interested, including the names of persons in relation, the nature, conditions, durations and the amount of the business or contract. If there are no such businesses or contracts, the company must submit a statement thereof.
- 35) a description of any arrangement or agreement under which a director or a Senior Executive of the company has waived any remuneration.
- 36) a description of any arrangement or agreement under which a shareholder of the company has waived any rights to dividends.
- 37) a statement of the value of any paid and outstanding statutory payment on account of any zakat, taxes, fees or any other charges that have not been paid until the end of the annual financial period with a brief description and the reasons therefor.
- 38) a statement as to the value of any investments made or any reserves set up for the benefit of the employees of the company.
- 39) declarations that:
 - a. proper books of account have been maintained;

- b. the system of internal control is sound in design and has been effectively implemented;
and
 - c. there are no significant doubts concerning the company's ability to continue its activity.
- 40) if the external auditor's report contains reservations on the annual financial statements, the Board report shall highlight this mentioning the reasons and any relevant information.
- 41) if the Board recommended replacing the external auditor before the end of its term, the report shall indicate this mentioning the reasons for the replacement recommendation.

Article 91: The Audit Committee's Report

- a) The report of the audit shall include details of its performance of its competencies and duties stated in the Companies Law and Its Implementing Regulations, provided that the report contains its recommendations and opinion on the adequacy of the internal and financial control systems and risk management systems in the Company.
- b) The Board shall make available sufficient copies of the audit committees' report at the Company's head office, and publish them on the Company's and the Exchange's websites when publishing the invitation to convene the General Assembly, to enable shareholders to get a copy thereof. Summary of the report shall be read at the General Assembly.

Article 92: Disclosure by the Board

The Board shall regulate the disclosures of each of its members and the members of the Executive Management, observing the following:

- 1) maintaining a register for the disclosures of the Board members and the Executive Management and updating it regularly based on disclosures required as per the Companies Law, the Capital Market Law and their implementing regulations; and
- 2) making such register available for review by the Company's shareholders free of charge.

Article 93: Disclosure of Remunerations

- a) The Board shall:
 - 1) disclose the remuneration policy and the method by which remunerations of the Board and executive management are determined;
 - 2) provide an accurate, transparent and detailed disclosure in the Board report on the remunerations granted to the Board members and Executive Management, directly or indirectly, without any omission or misleading information, and whether these were in cash or other benefits of any nature. In case they were shares of the Company, the value of the shares is the market value on the due date;
 - 3) explain the relationship between remunerations granted and applicable remuneration policy, highlighting any significant deviation from such policy;
Board
 - 4) a description of the necessary details with respect to the remunerations and compensations granted to each of the following, separately:
 - a. Board members;

- b. five Senior Executives who have received the highest remuneration from the Company, provided that the chief executive officer and chief financial officer are among them.²¹
 - c. members of committees.
- b) The disclosures in this article and in the Board report shall be pursuant to the appended schedule.

Part 10: Implementation of Corporate Governance

Article 94: Implementation of Effective Governance

The Board shall establish governance rules for the Company in accordance with the provisions of these Regulations, and shall monitor their implementation, verify their effectiveness, and amend them as necessary. To that end, the Board shall:

- 1) verify that the Company is in compliance with these rules;
- 2) review and update the rules pursuant to statutory requirements and best practices;
- 3) review and develop codes of professional conduct representing the Company's values and other internal policies and procedures in order to fulfill the Company's requirements and in accordance with best practices; and
- 4) regularly inform the Board members of the developments in corporate governance and best practices, or authorise the audit committee or any other committee or department to undertake this task.

Article 95: Formation of a Corporate Governance Committee²²

²¹ The Capital Market Authority Board issued its Resolution Number 1-35-2018 Dated 9/7/1439H Corresponding to 26/3/2018G stating that the remunerations of senior executives mentioned in sub-paragraph (b) of paragraph (4) of Article 93 of the Corporate Governance Regulations is to be disclosed collectively.

If the Board forms a corporate governance committee, it shall assign to it the competences stipulated in Article (94) of these Regulations. Such committee shall oversee any matters relating to the implementation of governance, and shall provide the Board with its reports and recommendations at least annually.

Part 11: Retaining of Documents

Article 96: Retaining of Documents

A company shall retain all minutes, documents, reports and other papers required to be maintained in the company's head office for at least ten years as per these Regulations. This shall include the Board report and audit committee report. Without prejudice to this period, a company, in case of any lawsuit (filed or threatened to be filed) or ongoing claim or any investigation relating to those minutes, documents, reports and other papers, shall maintain them until the end of the ongoing lawsuit, claim or investigation.