

CORPORATE GOVERNANCE PRACTICES IN SAUDI
JOINT STOCK LISTED COMPANIES: PRIORITIZATION
OF CHARACTERISTICS WITH AHP AND
STATISTICAL ANALYSIS

BY

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ABSTRACT

Today, corporate governance is seen as one of the most important topics in the contemporary business world and it has been introduced in the 1980s' literature as a mechanism to improve accountability, efficiency, transparency and effective corporate management in business environment. Moreover, the corporate governance is categorized as one of the key determinants of the sound enterprise system, since it has the capacity to mitigate economic hits and it shows how the individual elements of the organization are linked together to improve that system. Saudi authorities have recalled corporate governance as a corruption uprooting tool and an approach to create sustainable business across the world. The Saudi Vision 2030 requires that the company directors, management and other stakeholders should acquire the strategic vision on good corporate governance practices, particularly the economic development as a crucial element in Vision 2030. This study aims at identifying and prioritizing the characteristics that are expected to enhance effective corporate governance practices in Saudi joint stock listed companies. This research adopted a sequential mixed method (qualitative followed by quantitative) approach to pursue the research objectives. The quantitative phase was implemented following an approach usually adopted in a case study research. The findings resulted from the qualitative analysis explained that 16 characteristics were identified as positively enhance governance practices in Saudi joint stock listed companies. The results obtained from the quantitative part showed that board independence is relatively the most important characteristic while ownership structure is the least important in enhancing good governance practices in Saudi listed companies. Finally, the overall findings resulted in developing a new model for effective corporate governance practices in Saudi listed companies.

ملخص البحث

تعد حوكمة الشركات واحدة من أكثر القضايا أهمية في عالم الأعمال اليوم وقد تم تقديمها في الأدبيات في الثمانينيات كآلية لتحسين المساءلة والكفاءة والشفافية وإدارة الشركات الفعالة في بيئة الأعمال. تعتبر حوكمة الشركات أيضًا أحد المحددات الرئيسية للنظام المعافى في المنظمة، كما لديها القدرة على امتصاص الصدمات الاقتصادية وعكس كيفية ارتباط المكونات الفردية للمنظمة لتعزيز هذا النظام. عرّفت الحكومة السعودية حوكمة الشركات كأداة للقضاء على الفساد وهي ليست مجرد قضية تشريعية ولكنها وسيلة لإنشاء أعمال مستدامة في جميع أنحاء العالم. تتضمن رؤية المملكة العربية السعودية 2030 أن يمتلك أعضاء مجلس إدارة الشركات والمدراء التنفيذيون والموظفون والجمهور الرؤية الإستراتيجية لممارسات الحوكمة الفعالة للشركات بما في ذلك التنمية الاقتصادية كجزء أساسي من رؤية 2030. تهدف هذه الدراسة إلى تحديد وترتيب خصائص الحوكمة وفقاً لأهميتها النسبية والتي من المتوقع أن تعزز ممارسات الحوكمة في الشركات السعودية المساهمة والمدرجة. استخدم هذا البحث المنهج المزدوج (النوعي ثم الكمي) لتحقيق أهداف البحث. تم تنفيذ المرحلة الكمية باتباع نهج يتم اعتماده عادة في بحث دراسة الحالة. وتبين النتائج التي تم الحصول عليها من التحليل النوعي أن هنالك (16) خاصية تؤثر بشكل إيجابي على ممارسات الحوكمة في شركات المساهمة المدرجة. وأوضحت نتائج التحليل الكمي أن استقلالية مجلس الإدارة هي السمة الأكثر أهمية نسبيًا في حين أن هيكل الملكية هو الأقل أهمية في تعزيز ممارسات الحوكمة الجيدة في شركات المساهمة المدرجة. خلصت النتائج الكلية إلى تطوير نموذج جديد لممارسات الحوكمة الفعالة في شركات المساهمة السعودية المدرجة.

APPROVAL PAGE

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DECLARATION

I hereby declare that this dissertation is the result of my own investigations, except where otherwise stated. I also declare that it has not been previously or concurrently submitted as a whole for any other degrees at IIUM or other institutions.

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DEDICATION

This thesis is dedicated to my parents, Alsurrah Alnijoomi and Malik Haidoub for laying the foundation of what I turned out to be in life.

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LIST OF ABBREVIATION

| Abbreviations | Description |
|----------------------|--|
| SJLCs | Saudi Joint Stock Listed Companies |
| ACE | Audit Committee Expertise |
| ACI | Audit Committee Independence |
| AHP | Analytic Hierarchy Process |
| BC | Board Composition |
| BED | Board Expertise Diversity |
| BI | Board Independence |
| BM | Board Meetings |
| CEO | Chief Executive Officer |
| CMA | Capital Market Authorities |
| NCI | Nomination Committee Independence |
| OECD | Organization for Economic Co-Operation and Development |
| OS | Ownership Structure |
| RCI | Remuneration Committee Independence |
| SP | Separation of Position |
| SRCG | Saudi Regulations of Corporate Governance |

CHAPTER ONE

INTRODUCTION

1.1 BACKGROUND OF THE STUDY

This study aims at exploring the corporate governance characteristics or attributes that are perceived by corporate governance experts as the most important factors in enhancing good corporate governance practices in Saudi joint stock listed companies (SJLCs). In the first place, the study tries to explore and identify the most relevant characteristics of corporate governance and then examines the experts' opinions on characteristics' relative importance by adopting an appropriate ranking technique and analytical tool.

Corporate Governance is one of the most critical issues in today's business world and It has recently appeared in the literature since the 1980s as a mechanism for improving accountability, efficiency, transparency and effective governance practices in the business environment. According to Naif and Ali (2019), corporate governance concept has come into exist to address the financial scandals and corporate malpractice as experienced by countries worldwide. Turrent and Ariza (2016) pointed out that, it is a newly arisen concept due to a number of successive scandals such as Enron and Andersen in United States of America.

In fact, there is no one single definition of corporate governance among researchers and writers but the most popular and simple definition of corporate governance in the business context is described as the systems of rules, practices and processes by which profit and non-profit organizations are controlled and governed (Yourmatter, 2020). Similarly, Mzenzi, Mori and Kurt (2019) declared that corporate governance is the manner in which business entities are directed and controlled.

Sarbah and Xiao (2015) reported that corporate governance is considered as one of the major determinants of the enterprise health system and its ability to absorb economic shocks and how the individual components of the organization connected to enhance that system. Villiers and Dimes (2021) reported that corporate governance is the exercise of ethical and effective leadership by the governing body towards the achievement of ethical culture, good performance and legitimacy. Mbonde (2019)

viewed corporate governance as a useful instrument for enhancing and promoting social economic development. He concluded that corporate governance is important for reinforcing public services provisions, efficiency, effectiveness and economy across the world

Meteb (2015) mentioned that corporate governance provides an appropriate organization by which corporate goals and the effective methods of how to achieve these goals are developed. In fact, there is no single definition for corporate governance and the term generally used to mean the processes, practices and the established structures such that the corporate matters are managed to achieve strategic, operational and financial objectives and ultimately to realize a long-lasting sustainability (Erma Academy, 2016). Rizaee (2009) documented that corporate governance has gained renewed interest and relevance in recent years and is now emerging as a central issue within public companies. Companies have recently undergone a series of corporate accountability reforms resulting from government regulations, the emergence of powerful institutional investors, listing standards of national stock exchanges and guiding principles and best practices of investors activism.

Gyamerah and Agyie (2016) reported that the concept of corporate governance has become a global issue of interest to both business directors, academicians and researchers. In fact, this new trend is attributed to recent global financial crises caused partly by non-reliable corporate governance practices adopted by firms at corporate levels. Fudda (2014) noted that corporate governance practices provide a means for ensuring sustained company performance and embedding the values of accountability and transparency in organizations.

Claessens and Yurtoglu (2012) mentioned that, two decades ago, the term of corporate governance had little concern to the majority but today has become a mainstream issue to a handful of scholars and shareholders. Alujana and Tomczyk (2018) illustrated that corporate governance remains one of the most intensively researched themes in the finance and business field, showing a dynamic development in practice regulations. Hence, the term “corporate governance” has become very common and famous worldwide.

Although corporate governance has played an important role in developing the economic value at a corporate level and the economies of different countries as well, the debate on the concept of corporate governance has a long-standing history.

1.2 THE CONCEPT OF GOOD CORPORATE GOVERNANCE

It is internationally recognized that good corporate governance has a positive impact on the performance of companies and enables them to move into the next phase of the business lifecycle. As companies grow and become more conversant with good governance, their ability to attract capital from external sources also improves, allowing them to expand, diversify, and acquire other businesses in a sustainable manner (CIPE, 2014). Good corporate governance therefore contributes to sustainable economic development by enhancing the performance of companies and increasing their access to outside capital (Sarbah and Xiao, 2015).

In their study, Alujan and Tomczyk (2018) asserted that one of the most challenging issues for business managers is to maximize shareholders' value and hence improve corporate performance. In the same way, Das (2017) indicated that the core goal of any business entity is to maximize shareholders' wealth and that wealth is generated through its management decisions, practices and actions. According to Mousavi and Moridipour (2013), good corporate governance increases the quality of listed companies, encourages managers to maximize shareholders' returns and protect their interests. It is also a solid base for healthy market securities and minimize speculations violations of market rules. They believed that the quality of governance systems depends on applying corporate governance principles and performance standards in such a way that support solving problems such as conflict of interest, transparency, fairness and disclosure needed to meet shareholders' interests.

Tipuric, Dvorski and Delic (2020) argued that good governance represents quality if it responds to the firm's guiding principles and strategic directions and whether that firm does the right and reliable decisions and actions to ensure the desired results in an integrated monitoring system for business control. Djokic and Duh (2016) reported that good corporate governance is intended to reduce agency costs and to adjust information asymmetry resulted from the separation between ownership and control. They added that effective corporate governance is characterized by good monitoring and disciplining characteristics that is supposed to alleviate opportunistic behavior of top management.

1.3 CORPORATE GOVERNANCE SYSTEMS

Shirwa and Onuk (2020) documented that nowadays every state tends to practice corporate governance activities by adopting certain techniques and approaches that are appropriate to their customs, cultural context, economic setting, political environment and legal framework. Generally speaking, there are three models of corporate governance globally adopted.

The most prominent model is the shareholder model of corporate governance. This model is built on principles, which indicates that any company chooses this model have to show the compliance with the governance regulations using coding system or “explain and justify” of non-complying with them.

The “Anglo-US system” is controlled by independent stockholders while the executive is accountable to both directors and to the stockholders. There are three levels constitute the governance system: The shareholder’s system which represents the highest power level, the second is the board power which derived from the shareholder’s power and finally the executive power, the lowest, that is authorized by board of directors.

The second is the stakeholder approach whereas the owners of a publicly traded company are made of few investors. Shirwa and Onuk (2020) reported that this model is distinguished by an insufficient level of disclosure, the corporate ownership centred around a small group of people, and minimum disclosure levels. The adoption of this approach in Europe and Japan is due to the insignificant role played by the publicly traded companies in the economy and the concentration of ownership compared to other states that adopt the “shareholder approach”.

Haider (2019) stated that the stakeholders model recommends that the firm concerned parties such as senior employees, creditors, customers, suppliers and others required to participate in the issues of “corporate governance” and grant them ownership-like incentives in addition to aligning their interests with the interests of shareholders since they contribute to the firm’s value maximization goal. It is recommended to encourage long-term employee ownership and to motivate the significant customers, suppliers' financial advisors and employees to be represented on the board of directors. In practice, the stakeholder system is subcategorized into the Continental-European model and the Japanese model.

The Continental-European model also known as German model since it includes continental European countries such as Germany and the Netherlands. The continental model has two-tiered board. The management board composed of daily operating executives while the governance board, made of purely non-executive board members who are authorized to act on behalf of shareholders (Kousalya, Revathi and Mohan, 2013).

According to Mathur (2009) Japan has a unitary board like British and American models and the corporation is controlled by members of executive management covering over 75% of board members who are mainly executives. Ungureanu (2007) argues that the executives' accountability demonstrates itself relative to shareholders and a network of loyal suppliers and clients. The quality pattern of governance is controlled by two types of legal relationships: one is the collective cooperation between shareholders and unions, customers, suppliers, creditors, government and another relation is between governors and the stakeholders, and executives as well.

According to Zainullin, Egoryasheya, Bondarchuk and Kurashova (2018) the corporation is controlled by the president, the CEO and the board of directors. Requirements for the directors include qualification and expertise in the company's operations and activities. The share of independent board members should be not less than one third. Before new members of the board of directors are appointed, they should pass a filter of the CEO and the President's assertion about the candidates' qualification and competence, after which the board members take a vote. The discipline and requirements of appointing the outside directors and members of audit and supervision is provided separately.

1.4 CORPORATE GOVERNANCE IN SAUDI ARABIA

Naif and Ali (2019) documented there are two stages covering the evolution of corporate governance. Stage one started in 1985 to enforce the standards of transparency and disclosure. It is worthy to mention that transparency and disclosure are considered as the most significant elements of corporate governance best practices. Stage two involved the passing of "Capital Market Law" of 2003 and the issuance of regulations by the Capital Market Authority (CMA) Board. In 2006, the corporate governance

regulations were set to be compatible with the global measures on transparency, disclosure, stockholders' rights, and "General Assembly and Board of Directors.

The CMA in the Kingdom of Saudi Arabia began informally in the early fifties, and continued to make successful achievements, until the government introduced the basic regulations in the eighties. The CMA is a governmental body characterized by complete financial, legal and administrative independence, and it has direct relations with the Prime Minister. The roles of the authority are to regulate the Saudi capital market and improve its performance by preparing the necessary laws and regulations to implement the provisions of the Capital Market Law. The main objectives are to provide an attractive environment for investment, build confidence, apply transparency and disclosure standards in all public listed companies, as well as the need to safeguard shareholders from unlawful activities in the market.

The Saudi Capital Market Law provides for the establishment of the "Saudi Stock Exchange" as a joint stock company operating to be the only entity authorized to trade securities in Saudi Arabia. The stock exchange's activities are currently carried out through the Saudi Stock Exchange (*Tadawul*), for the purpose of continuous improvement of a safe and integrated market that provides comprehensive and diversified financial services to compete at the international level (CMA, 2015).

Naif and Ali (2019) argued that before 2006, there were no well-identified regulations to direct corporate governance in Saudi Arabia. CMA came into exist in 2003 and only after three years CMA was able to issue a regulation on corporate governance. In 2006, the Saudi stock market suffered a big crash and this necessitates CMA to produce and approve novel governance regulations to safeguard shareholders and other stakeholders.

Alshehri (2012), Hill et al. (2015) and Meteb (2015) proved that the Saudi Regulations on Corporate Governance (SRCG) 2006 is apparently influenced by the "Organization for Economic Co-operation and Development" (OECD) Principles. The newly issued SRCG 2017, enhances shareholders' rights and directors' position to accomplish their duties and assume their responsibilities. In order to strengthen the regulatory oversight of SJLCs, CMA has carried out a lot of efforts to align its codes and principles with the global stock exchanges.

However, Hammad (2019) informed that that the corporate governance regulations in Saudi Arabia are in its early stage and not yet sufficiently mature and this is attributed to the delay in adopting a strong corporate governance system, particularly,

after the first market collapse in 2006. Few public organizations have played critical roles in establishing the platform for implementing relevant corporate governance standards in Saudi Arabia. Yet, the governance legislations in Saudi Arabia rise from two sources:

- The Companies Act of 1965 that was initially regarded the first legislative attempt at establishing general corporate governance guidelines.
- The Saudi Capital Market Law of 2004 which is considered as the first legislative attempt to regulate the Saudi Capital Market's operations of listed companies.

1.5 STATEMENT OF THE PROBLEM

The corporate governance concept has gained a lot of consideration worldwide due to the corruption that affected the economic and financial system and resulted in the famous crises that hit a number of states in East Asia, Latin America and Russia last decade of twentieth century. However, in Saudi Arabia, the term corporate governance has gained much more attention since the creation of 2030 vision.

Rahman and Qattan (2021) explained that the Saudi authorities has initiated leading efforts to diversify the economy and plan to improve the economic position of the country but the obtained outcome was not completely satisfactory due to unexpected fluctuations in oil prices between 1980 and 2017. The country faced a budget deficit of SAR367 billion in 2015 and SAR297 billion in 2016. Similarly, oil revenues dropped from US\$277 billion, USD\$163 billion, and US\$141 billion in 2014, 2015, and 2016 respectively. The government expected to overcome these economic challenges by diversifying the economy instead of oil dependency and by leading the economy with strong and prudent management.

Hammad (2019) reported that the good governance has become in its all kinds a main condition required to realize sustainability and development in Saudi Arabia. Saudi government has identified corporate governance as a corruption eliminating tool and it is not only an issue of legislation but a way to create sustainable business across the world. The Saudi Vision 2030 requires that the corporate stakeholders should possess the long-term vision on effective corporate governance as a crucial part in Vision 2030. In his opinion, good governance has become a prerequisite for achieving sustainable development by unleashing human capabilities in a sound economic, legal and social environment. He added, this trend leads to solving unemployment problems,