



Faculty of Economics and Business

The Moderating Role of CEO's Education on the effect of Corporate Governance Mechanism and Firm's Performance in Saudi Arabia's Non-Financial Sector

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The Moderating Role of CEO's Education on the effect of Corporate
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Financial Sector

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DECLARATION

I declare that the work in this thesis was carried out in accordance with the regulations of Universiti Malaysia Sarawak. Except where due acknowledgements have been made, the work is that of the author alone. The thesis has not been accepted for any degree and is not concurrently submitted in candidature of any other degree.

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ABSTRACT

Recent scandals at Wells Fargo and Equifax-the financial crisis of 2008 and the new millennium scandals in Enron, WorldCom, Tyco, and Qwest have put back on the policy agenda and intensified debate on the efficacy of corporate governance mechanisms as means of increasing firm performance. At the backdrop of this scenario, Saudi Arabia has lately revamped its codes for corporate governance. Empirical work in corporate governance has undergone a remarkable growth, however despite the volume of empirical evidence, there has been no consensus as to which corporate governance mechanism resolves the agent principal conflict and increase performance. Therefore, this study has addressed this problem by creating and validating corporate governance mechanisms model on 114 non-financial firms listed on the Saudi stock Exchange Tadawul spanning the period of 2015–2018. This thesis offers novel evidence detailing the impact of corporate governance mechanisms measured by board size, audit quality, and ownership concentration as the independent variable and CEO education as the moderator variable on the performance of Saudi listed firms using a contingent theoretical-based framework drawing on agency theory and upper echelon theory. Numerous alternative specifications and estimation techniques are used for analysis purpose, including system generalized methods of moments, which effectively overcomes the problem of endogeneity and pre-estimation, and post-estimation tests were conducted for the validity of the model. This thesis used positivist approach where the longitudinal/panel data is secondary and quantitative in nature which was collected from 2015-2018 that was analyzed using STATA 14. The thesis employed the balanced panel data of 114 listed non-financial firms and analyzed after controlling for potential endogeneity using a more robust methodology-a two-step system Generalized Method of Moments (GMM) framework. The results show that there is a significant impact of board size,

ownership concentration on firm performance measured by ROE and ROA, however audit quality illustrated significant impact on firm performance when measured with ROE and no significant impact when measured by ROA. This research expands the upper echelon theory in strategic management literature by confirming that CEO's education significantly influences governance mechanisms and firm performance. Moreover, it extends the agency theory in finance literature by recommending and validating proxies to select and measure corporate governance mechanisms (board size, ownership concentration, audit quality) that significantly mitigate the problem of agency in the contemporary business environment in 114 non-financial firms in Saudi Arabia from 2014-2018. The results show that firm performance deteriorates with board size, while performance improves with ownership concentration and audit quality. The results also indicated that CEO education moderates the relationship between board size, audit quality, ownership concentration on firm performance. The implications of this research are manifold. First, the implementation by Saudi Arabia of the latest corporate governance regulations and IFRS adoption almost certainly impact firm performance markedly. Second, corporate governance regulations should recognize the role of more concentrated ownership in enhancing corporate performance. Third, stakeholders should apply pressure on investee firms to maintain smaller boards and maintain audit quality by employing services of big four audit firms. And lastly the board must prefer hiring CEO with good level of education preferably graduates and above. Furthermore, the study should provide policy makers with a better understanding of the corporate governance structures required to promote better performance by drawing on existing theories and the empirical modeling, in an emerging economy setting such as Saudi Arabia, a new and broader data set, thereby informing better future policy and protecting shareholders' interests.

Keywords: Corporate governance, firm performance, audit quality, ownership concentration, CEO education

Mekanisma Tadbir Urus Korporat dan Prestasi Firma di Sektor Bukan Kewangan Arab Saudi: Peranan Moderasi Pendidikan CEO

ABSTRAK

Isu skandal terbaharu di Wells Fargo dan Equifax-krisis kewangan 2008 dan skandal alaf baharu di Enron, WorldCom, Tyco dan Qwest telah meletakkan kembali agenda dasar dan memperhebat perbincangan tentang keberkesanan mekanisme tadbir urus korporat sebagai cara meningkatkan prestasi firma. Berlatarbelakangkan senario ini, Arab Saudi baru-baru ini telah merombak kod tadbir urus korporat. Kerja empirikal dalam tadbir urus korporat telah mengalami pertumbuhan yang luar biasa, namun di sebalik jumlah bukti empirikal, tidak ada konsensus mengenai mekanisme tadbir urus korporat yang mana menyelesaikan konflik prinsipal ejen dan meningkatkan prestasi. Oleh itu, kajian ini telah menangani masalah ini dengan mencipta dan mengesahkan model mekanisme tadbir urus korporat pada 114 firma bukan kewangan yang disenaraikan di Bursa Saham Saudi Tadawul merangkumi tahun 2015–2018. Tesis ini menawarkan bukti baharu yang memperincikan kesan mekanisme tadbir urus korporat yang diukur mengikut saiz lembaga, kualiti audit, dan kepekatan pemilikan sebagai pembolehubah bebas dan pendidikan CEO sebagai pembolehubah moderator ke atas prestasi firma tersenarai Saudi menggunakan rangka kerja berasaskan teori kontingen yang bersandarkan pada teori agensi dan teori eselon atasan. Banyak spesifikasi alternatif dan teknik anggaran digunakan untuk tujuan analisis, termasuk kaedah umum sistem momen, yang berkesan mengatasi masalah endogeneiti dan pra-anggaran, dan ujian pasca anggaran telah dijalankan untuk kesahihan model. Tesis ini menggunakan pendekatan positivis di mana data membujur/panel adalah sekunder dan bersifat kuantitatif yang dikumpul dari tahun 2015-2018 yang dianalisis menggunakan STATA 14. Tesis ini menggunakan data panel seimbang daripada 114 firma bukan

kewangan tersenarai dan dianalisis selepas mengawal potensi endogen melalui penggunaan metodologi yang lebih teguh iaitu sistem dua langkah rangka kerja Generalized Method of Moments (GMM). Keputusan menunjukkan terdapat kesan ketara saiz lembaga, penumpuan pemilikan ke atas prestasi firma yang diukur oleh ROE dan ROA, walau bagaimanapun kualiti audit menggambarkan kesan ketara ke atas prestasi firma apabila diukur dengan ROE dan tiada kesan ketara apabila diukur dengan ROA. Penyelidikan ini memperluaskan teori eselon atas dalam literatur pengurusan strategik dengan mengesahkan bahawa pendidikan CEO mempengaruhi mekanisme tadbir urus dan prestasi firma dengan ketara. Selain itu, ia memperluaskan teori agensi dalam literatur kewangan dengan mengesyorkan dan mengesahkan proksi untuk memilih dan mengukur mekanisme tadbir urus korporat (saiz lembaga, penumpuan pemilikan, kualiti audit) yang mengurangkan dengan ketara masalah agensi dalam persekitaran perniagaan kontemporari di 114 firma bukan kewangan di Arab Saudi dari 2014-2018. Keputusan menunjukkan bahawa prestasi firma merosot dengan saiz lembaga, manakala prestasi bertambah baik dengan penumpuan pemilikan dan kualiti audit. Keputusan juga menunjukkan bahawa pendidikan CEO menyederhanakan hubungan antara saiz lembaga, kualiti audit, penumpuan pemilikan terhadap prestasi firma. Implikasi kajian ini adalah pelbagai. Pertama, pelaksanaan peraturan tadbir urus korporat terkini dan penerimaan IFRS oleh Arab Saudi hampir pasti memberi kesan kepada prestasi firma dengan ketara. Kedua, peraturan tadbir urus korporat harus mengiktiraf peranan pemilikan yang lebih tertumpu dalam meningkatkan prestasi korporat. Ketiga, pihak berkepentingan harus memberikan tekanan kepada firma penerima pelaburan untuk mengekalkan lembaga yang lebih kecil dan mengekalkan kualiti audit dengan menggunakan perkhidmatan firma audit Big four. Dan akhir sekali lembaga mesti memilih untuk mengambil CEO dengan tahap pendidikan yang baik sebaik-baiknya mempunyai tahap pendidikan ijazah dan ke atas.

Tambahan pula, kajian itu harus memberikan penggubal dasar pemahaman yang lebih baik tentang struktur tadbir urus korporat yang diperlukan untuk menggalakkan prestasi yang lebih baik dengan menggunakan teori sedia ada dan pemodelan empirikal, dalam suasana ekonomi sedang pesat membangun seperti Arab Saudi, set data baharu dan lebih luas, dengan itu. memaklumkan dasar masa depan yang lebih baik dan melindungi kepentingan pemegang saham.

Kata kunci: *Tadbir urus korporat, prestasi firma, kualiti audit, tumpuan pemilikan, pendidikan CEO*

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LIST OF ABBREVIATIONS

AFS	Audit Firm Size
AQ	Audit Quality
ASE	Amman Stock Exchange
BSIZE	Board Size
CEO	Chief Executive Officer
CEOE	CEO Education
CG	Corporate Governance
CGS	Centre for Graduate Studies
CMA	Capital Market Authority
CML	Commercial Mortgages Law
DW	Durbin-Watson Test
EPS	Earnings Per Share
FEM	Fixed-Effect Model
FP	Firm Performance
GCC	Gulf Cooperation Council
GDP	Gross Domestic Product
GICS	Global Industry Classification Standard
GMM	Generalized Method of Moments
HCSE	Heteroscedasticity Consistent - Standard Error
IPO	Initial Public Offerings
KSA	Kingdom of Saudi Arabia
LROA	Lagged Return on Assets

LROE	Lagged Return on Equity
MENA	Middle East and North Africa
Nomu	Saudi Parallel Market
OCN	Ownership Concentration
OECD	Organization for Economic Co-Operation and Development
OLS	Ordinary Least Square
REM	Random Effects Model
ROA	Return on Assets
ROE	Return on Equity
ROSC	Report on the Observance of Standards and Codes,
SAMA	Saudi Arabian Monetary Agency
SRCG	Saudi Arabia Regulations on Corporate Governance
TMT	Top Management Team
TQ	Tobin's Q
UET	Upper Echelon Theory
UNIMAS	Universiti Malaysia Sarawak
UK	United Kingdom
VIF	Variance Inflation Factor
2SLS	Two Stages Least Square

CHAPTER 1

INTRODUCTION

This opening chapter introduces the topic under investigation and provides a general discussion on the theories and variables to be used in this thesis. It discusses the background and context of the research problem. It offers a problem statement which outlines the research gaps along with presenting research questions and objectives of the study. Furthermore, it also describes the scope of the study along with highlighting the potential contributions and significance of this study. It goes on to include the conceptual definitions of the constructs to be used in this study. Finally, it outlines the structure of this PhD thesis. The details of each section are as follows; Section 1.1 discusses the background of the thesis, Section 1.2 elaborates the problem statement, Section 1.3 presents the significance of the thesis, Section 1.4 discusses the research questions, Section 1.5 elaborates the research objectives, Section 1.6 explains brief review of the underpinning theories, Section 1.7 highlights the scope of the thesis, Section 1.8 discusses the structure of the thesis, Section 1.9 discusses the definitions of the conceptual definitions of the key terms.

1.1 Study Background

Corporate governance gained substantial attention from the scholars and has recently come to the forefront of policy debates around the globe. It refers to the way all stakeholders including managers, stockholders, employees, creditors, consumers, and societies, interact with each other to form the strategy of the corporation. Under weak governance framework opaque corporations are more likely to bypass law and the efficacy of government, making and enduring a vicious circle of corruption, enticement, and mismanagement. At present corporate governance is a staple of discussion in academia, corporate meetings, and policy

makers. The scandals such as Man Financial Global, Royal Dutch Shell, Royal Bank of Scotland, Bear Stearns, Countrywide Financials, WorldCom, Enron, Siemens, and Satyam in the last decade have positioned the corporate governance mechanisms under scrutiny (Almoneef & Samontaray, 2019). Russia, Asia, and Brazil financial crises in 1998, followed by scandals in the United States and Europe-inadequacies in corporate governance have jeopardized the global financial system stability (AlRuthia et al., 2018).

The crises are indicators of various structural elements and underline as to why corporate governance has become even more significant for economic development and society's well-being. As the firms expand the task of financial intermediaries and institutional investor's increases, the mobilization of capital progressively develops; the distribution of investment also becomes more intricate. Structural reforms, including price deregulation and increased competition, have extended corporations' exposure to market forces. These advances have made the monitoring investment usage more complex in numerous aspects, augmenting the necessity for good corporate governance (Krane & Majid, 2018).

Theoretically, Corporate Governance (CG) is believed to increase firm's performance and secure stockholder's interest. In addition, good governance practice can build an encouraging investment opportunity. Compliance with CG systems improves corporate performance and promotes effective internal governance and management control. Undoubtedly external and internal governance mechanisms help to oversee agent's daily activities, on behalf of the principals (Babatunde et al., 2009). Corporate governance has become more pertinent in existing times as corporations expand both in advanced and emerging economies (Freeman, 1983, 2010). Its significance has been emphasized by

substantial body of research as it supports capital market development, attracts foreign investments, develops market efficacy, and reduces susceptibility to financial catastrophe (Shank et al., 2013).

In emerging markets, the necessity for corporate governance is more pressing than developed countries, since there is a paucity of regulation by professional agencies, petite, or no awareness of the criticality of corporate governance, weak guidelines, insignificant transparency, and non-observance to corporate governance standards. Emerging markets have strengthened their position in the global economy during the last two decades. From 2010 till 2015 emerging economies accounted for more than a quarter of global output when compared with just about 1/10th and 1/5th respectively in the 1990s (Huidrom et al., 2019) Giving credit where due, emerging market economies have made momentous corporate governance strides lately, as the implementations and amendments of governance codes and pertinent guidelines have led to improved disclosure standards, higher levels of board independence, and more stockholder protections (Mishra, 2019) Generally preceding literature was driven by the principal-agent problems in emerging markets-that differs from the developed markets on many facets including ownership structure' identity, size (La Porta et al., 1999), direct ownership – known as cash flow rights, and control rights – of those who has de facto power over the business (Claessens et al., 2000).

Governance improvements across emerging markets have been uneven. However, the overall progress observed in several areas is encouraging. Regulators have also taken measures to empower minority stockholders by providing them more say. According to the report by the World Bank, it was noted that emerging economies came very far and have successfully adapted standards and regulations practiced in developed countries in order to