

DOES CORPORATE GOVERNANCE AFFECT FINANCIAL PERFORMANCE IN THE BANKING SECTOR?

EVIDENCE FROM SAUDI ARABIA

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Abstract

This study examines the relationship between corporate governance variables and financial performance of all listed banks in Saudi Arabia. The archival data for this study uses the entire population of listed banks on the Saudi Stock Exchange. The annual reports for all listed banks in Saudi Arabia for years 2009 and 2012 have been analysed. The study uses different variables of corporate governance (board size, independence, CEO status, and audit committee and ownership concentration) and three measures of financial performance (ROA, ROE and Tobins' Q). The results of this study show that board size, board independence and bank size have a significant positive relationship with banks' financial performance, whereas ownership concentration and leverage ratio have a significant negative association with banks' financial performance. However, the CEO status, audit committee size and audit committee independence are not related to banks' financial performance.

Keywords: Corporate governance, financial performance, banking sector, Saudi Arabia

INTRODUCTION

The literature concerning corporate governance shows that poor corporate governance in banks played a major role in the financial crisis. The global financial crisis and the stock crises in the Saudi Stock Market had a significant negative impact on the financial performance of Saudi Arabian banks (Al-Twajiry, 2011). According to Alghamdi (2012), the stock crises in the Saudi Stock Market exposed a serious weakness not only in the level of compliance of Saudi banks with the CGRs but the lack of disclosure, transparency and accountability which have a significant influence on banks stability and performance. A study done in 2006 by Al-Turki reveals that generally all firms in Saudi Arabia including banks had poor corporate governance practices (Al-Turki, 2006).

Studies of corporate governance in Saudi Arabia and in developing countries, in general, are sparse (Barth, Caprio, & Levine, 2001). Although there are many studies on different aspects of corporate governance in developed countries, (Andres & Vallelado, 2008; Gompers, Ishii, & Metrick, 2003; Guest, 2009; Magalhaes, Gutiérrez, & Tribó, 2008), the results of such studies cannot be generalized to developing countries due to cultural, social, economic variations between developed and developing markets. According to Mueller (2006) and Kouwenberg (2007), due to the contextual differences between developing and developed countries, the results of the studies related to developed countries have limited applicability in developing countries. Therefore, it is necessary to investigate corporate governance issues in emerging markets (Manawaduge, 2012).

There have been few studies investigating the issues relating to corporate governance in Saudi Arabian firms in the last decade (Al-Hussain & Johnson, 2009; Al-Moataz, 2003; Alsaeed, 2006). However, most of these studies examine the corporate governance issues at the early stages of implementing corporate governance in Saudi Arabia in 2006. In addition, most of previous studies have a narrow focus on a single aspect of corporate governance, which is board of directors, while ignoring other factors that are important within the governance framework. Furthermore, the relationship between corporate governance and financial performance has also received less attention especially in banking sector.

The purpose of this study is to examine the relationship between corporate governance variables and banks' financial performance of all listed banks in Saudi Arabia. In particular, it is set to address the following questions:

Q1: Is there a relationship between board size and financial performance of Saudi banks?

Q2: Is there a relationship between board independence and financial performance of Saudi banks?

Q3: Is there a relationship between the separation of the positions of CEO and chairman of the board and financial performance of Saudi banks?

Q4: Is there a relationship between audit committee size and financial performance of Saudi banks?

Q5: Is there a relationship between audit committee independence and financial performance of Saudi banks?

Q6: Is there a relationship between ownership concentration and financial performance of Saudi banks?

LITERATURE REVIEW

The implications of corporate governance structures on banks' financial performance have been discussed in the existing literature. It is widely agreed that good corporate governance practices are an essential element for enhancing financial performance of a bank in both developed and developing countries (Rehman & Mangla, 2012). However, the impact of corporate governance on bank's performance differs in mature and emerging financial market as corporate governance systems in these market are dissimilar due to the different economic and social situations of these countries (Rashid, 2008). Economic and financial theory suggests a number of instruments that influence the performance of a firm in both developed and developing financial markets (Ranti, 2011). These instruments include board of directors characteristics (such as size, composition, and audit committee) and ownership structure.

Various characteristics of board of directors and their effects on banks' financial performance have been of interest to researchers. It is argued that larger boards can improve financial performance because they have diversity experiences and skills which help make better decisions (Setia-Atmaja, Tanewski, & Skully, 2009). Stepanova and Ivantsova (2012) support this argument by pointing out that due to that fact that banking sector varies from the other sector, and thus additional skills, experience and knowledge provided by larger boards lead to better bank performance. Andres and Vallelado (2008) investigate 69 banks in different developed countries and found a reverse nonlinear relationship between board size and bank performance in terms of Tobin's Q and ROA. A positive relationship between board size and banks' return on assets has been also observed in some developing countries such as Ghana (Kyereboah & Biekpe, 2006).

On the other hand, a negative relationship between board size and bank's profitability measured as ROE is reported in a study of all listed banks in Nigeria in 2009 (Uwuigbe & Fakile, 2012). Such a result is consistent with another study of 58 large European banks which shows a negative association between board size and financial performance as ROA, ROE and Tobin's

Q (Staikouras, Staikouras, & Agoraki, 2007) and supports the argument that large board size leads to poor decision making and poor communication and interaction (Guest, 2009).

The relationship between outsider directors in the board and the financial performance of banks has been widely debated. Pathan, Skully, and Wickramanayake (2007) report a positive relationship between the degree of board independence and bank performance measured as ROE and ROA for Thai banks. On the same line, Busta (2008) found the same relationship between outsider directors and bank performance in terms of market-to-book value and return on invested capital (ROIC) for banks in continental Europe. However, the researcher reports a negative relationship for banks in the UK. Another study done by Kyereboah and Biekpe (2006) examines the relationship between ROE of banks in Ghana and outside directors. They conclude that the more independence a board is, the worse performance of a bank. This finding is supported by another study undertaken by Becht, Bolton, and Röell (2011) to investigate the causes behind the failures of banks in Europe and the UK and Australia during the financial crisis. The study reveals that, on average, banks with less independent boards incurred fewer losses.

Audit committee characteristics affect the firm performance in terms of risk management, earning management and financial decision (Klein, 2002). According to Chan and Li (2008), a high level of expertise and independence on audit committee improves firm value. Aldamen, Duncan, Kelly, McNamara, and Nagel (2012) investigate the impact of audit committee on the firms' performance during times of global financial crises. The sample includes all listed companies in Australian stock exchange (ASX300) for years 2008 and 2009. The empirical results indicate that the size and independence of the audit committee are associated with higher company performance. A similar result is also found in a study done by Wild (1996) which shows that the performance of firms with audit committees is better than the performance of those without. However, a study done by Brown and Caylor (2006) reveals that there is no relationship between audit committee and firm performance. Despite the importance of the audit committee roles, there is a paucity of research on the effect of audit committee on financial performance especially in banking sectors.

A number of studies have been done to investigate the implications of CEO duality. Agrawal and Knoeber (1996) argue that the separation of chairman and CEO roles can lead to better financial performance. The impact of the separation of chairman and CEO roles would be more significant in high-complexity institutions such as banks (Donaldson & Davis, 1991). A study conducted by Hugh Grove, Patelli, Victoravich, and Xu (2011) to investigate 236 banks in the US for the period 2006 to 2008 shows that CEO duality is negatively associated with banks' financial performance. On the other hand, a study done by Arouri, Hossain, and Muttakin (2011)

reveals that the CEO duality has insignificant impact on banks performance measured as ROA in Gulf Cooperation Council (GCC) countries. The same has been reported in Indian banks and Turkish banks (Bektas & Kaymak, 2009; Pandya, 2011). Although the conclusions of the literature were not unanimous, the weight of opinion is that the separation between chairman and CEO role has an important impact on banks' performance.

Empirical studies on the impact of ownership structure on bank's financial performance have conflicting results. While the advantage of ownership concentration can be recognized as a high control and monitor for the management acts, the disadvantages also may occur if they target other goals beside maximizing stock price (Shleifer & Vishny, 1997). H. Grove, Patelli, Victoravich, and Xu (2009) examine the relationship between ownership structure and financial performance of US banks. The study found that the presence of a higher ownership concentration is positively associated with performance in terms of ROA and Tobin's Q. Magalhaes et al. (2008) analyse the data of 818 banks around 40 countries and they found a cubic relationship between banks' profitability and ownership concentration. Busta (2008) points out that the effect may vary in different countries as ownership concentration can be beneficial in Franc and Scandinavian countries, but it can be punished in UK and Germany. A study of large European banks by Iannotta, Nocera, and Sironi (2007) shows that bank's profitability is not associated with ownership concentration. Rowe, Shi, and Wang (2011) investigate the impact of ownership structure on the performance of Chinese banks. The study found a positive relationship between lower block ownership and banks' performance.

In respect to the impact of state ownership, research shows a negative impact of state ownership on bank performance (Busta, 2008; Micco, Panizza, & Yañez, 2007; Pinteris, 2002; Zeitun & Tian, 2007). However, there is a potential positive effect of state ownership in times of global financial crisis. This could be supported by the evidence from Asian crisis in early 2000s (Cornett, Guo, Khaksari, & Tehranian, 2010).

Based on a study to investigate the impact of institutional ownership on banks' performance in Kenya, Barako and Tower (2007) conclude that there is no impact of institutional ownership on performance. In addition, different studies highlight the relevance of foreign ownership structure to bank's financial performance. For example, Arouri et al. (2011) investigate 27 banks in the GCC countries for the year 2008 and report that the foreign ownership level has a significant positive impact on the bank performance measured as ROA. The same finding was revealed in a study on Korean banks (Choi & Hasan, 2005) and on Kenyan banks (Barako & Tower, 2007).

There are a few studies that investigate corporate governance in Saudi Arabia (Al-Hussain & Johnson, 2009; AlNodel & Hussainey, 2010; Alsaeed, 2006). A study of non-financial

listed companies in Saudi Arabia shows that board characteristics have no impact on firm performance (Ghabayen, 2012). Similarly, an investigation of 94 firms for the periods 2006-2009 shows that corporate governance is unrelated to firm value measured as ROA (Fallatah & Dickins, 2012). However, the study reveals a positive relationship between corporate governance and firm performance measured as Tobin's Q. Al-Hussain and Johnson (2009) investigate the relationship between corporate governance efficiency and banks' performance using a sample of nine Saudi banks for the periods 2004-2007. The results indicate that there is a strong association between the efficiency of corporate governance structure and bank performance measured as ROA, while there is a weak positive relationship when using stock return as a performance measure.

In the light of the review of previous studies of corporate governance in Saudi Arabia, it can be concluded that most of the previous studies concerning corporate governance in Saudi Arabia have been done in the first few years of the implementation of corporate governance in Saudi Arabia in 2006. Furthermore, the subject of corporate governance in Saudi Arabian banks has not been the primary focus even though banks play a vital role in the economic growth of Saudi Arabia. In addition, less attention has been drawn to the association between corporate governance attributes and bank's financial performance. Therefore, this study fills the gap in literature by examining the relationship between corporate governance variables and banks' financial performance.

CORPORATE GOVERNANCE VARIABLES

The study adopts the following variables to represent governance variables. These variables are the prevailing corporate governance mechanisms that are used in many previous corporate governance studies (Hussainey & Al-Nodel, 2008; Mohammed, 2012; Polo, 2007).

Board Size

The board of directors is the important part of the control system in any firm which is responsible for monitoring managements' action and protecting shareholders' interest (Jensen, 1993). Although there is no consensus about the optimal board size, some authors suggest it to be between seven and nine directors (Lipton & Lorsch, 1992). Due to the importance of the board size to firms performance (Pathan et al., 2007), the study investigates this variable.

Board Independence

Board independence depends on the number of non-executive directors on the board. Non-executive directors can be defined as "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” (CMA, 2006, p. 4). With their knowledge and experiences, outside directors can enhance firm’s performance, as well as protect shareholders’ interest through effective decision making (Weisbach, 1988).

CEO Status

Agency theory argues that the separation between CEO and chairman roles can reduce agency costs (Hugh Grove et al., 2011). The Cadbury Committee (1992) recommends that the positions of CEO and chairman should be separated. Agrawal and Knoeber (1996) argue that the separation of chairman and CEO roles leads to better financial performance. The impact of the separation of chairman and CEO roles would be more significant in high-complexity institutions such as banks (Donaldson & Davis, 1991).

Audit Committee

The Smith Report (2003) explains the role of audit committee which is “to ensure that the interests of shareholders are properly protected in relation to financial reporting and internal control” (P. 3). Despite the importance of the role that audit committee plays, there is little empirical studies have been done related to this mechanism (Kyereboah-Coleman, 2008). Therefore, this study investigate the role of audit committee size and independence in the Saudi Arabian banks.

Ownership Concentration

Ownership structure significantly affects the firms’ performance. Many studies highlight the importance of ownership concentration, especially in developing countries, to control the management practices and improve the performance (Versita, 2010). Ownership concentration can be define as the large-block shareholders and individual investors who own at least 5% of the firm’s share (Gupta, Gollakota, & Srinivasan, 2007). Previous studies in Saudi Arabia found that ownership concentration is widespread in Saudi companies (Falgi, 2009).

RESEARCH METHODOLOGY

The data for this study uses the entire population of listed banks on the Saudi Stock Exchange (Tadawul). The study analyses the annual reports of the 11 Saudi banks in years 2009 and 2012. The study uses secondary data collected from the audited annual reports of the listed banks. Tadawel website, which is the official website of the Saudi Stock Exchange, is used to collect the annual reports for all listed banks for the years 2009 and 2012.

In order to measure banks' financial performance, the study uses three financial performance measures. These measures are return on assets (ROA), return on equity (ROE) and Tobin's Q. These measures are different in their perspectives. ROA and ROE are profitability ratios which are historic and backward-looking, whereas Tobin's Q is forward-looking based on market value. Regarding management achievement, while ROA and ROE measure the past achievement, Tobin's Q is an estimate of future achievement. These measures have been applied in different studies to assess the relationship between corporate governance and banks performance, and the results were different based on what measure was used (Fallatah & Dickins, 2012). This is consistent with the argument that "the use of only accounting or market based performance measures are responsible for the inconsistencies in establishing a clear relationship between corporate governance and corporate performance" (Kyereboah-Coleman, 2008, p. 7). In addition, the level of compliance with corporate governance best practices would enhance overall firms' performance and market value of the share. Thus, while accounting performance measures capture the effects of compliance with corporate governance on overall firm performance, market performance measures capture the impact of the level of compliance on market share prices. These measures are explained below.

Return on Assets (ROA)

Return on Assets is an important measure of how well a firm is managing its business (Dickie, 2006). The ROA is calculated as earnings before interest and tax to total assets (EBIT/TA).

Return on Equity (ROE)

Return on Equity is a measure of how successful a firm is in using shareholders' equity business (Dickie, 2006). The ROE is calculated as a net income to total equity (NI/TE).

Tobin's Q

Tobin's Q ratio was introduced by James Tobin to measure company's future investment (Tobin, 1969). The formula of Tobin's Q is the company's market value of equity plus the book value of debt divided by the book value of total assets. Market value of equity is calculated as the closing share price at the end of each financial year multiplied by the number of shares outstanding at the end of the same financial year. In order to calculate market value of equity, this study uses Tadawul website to obtain the closing share price at the end of each financial year (31 Dec.). Information related to the number of shares outstanding, book value of total debt and book value of total assets are obtained from annual reports of the 11 Saudi banks.

Organizational characteristics affect the corporate governance structure and, therefore, have possible impacts on the way that corporate governance affects performance (Markarian & Parbonetti, 2007). Similar to previous studies (Arouri et al., 2011; Bai, Liu, Lu, Song, & Zhang, 2004; Fallatah & Dickins, 2012), the study uses both bank size (SIZE) and the leverage ratio (LEVG) as Control Variables (CVs) to separate the effect of the corporate governance variables on corporate valuation. These CVs are widely employed in market valuation studies (Cho, 1998; Denis & McConnell, 2003). In addition, leverage ratio is a good indicator for corporate bankruptcy (Pervan & Višić, 2012). The higher the level of debt, the greater the risk of companies.

The analysis used in this study is mainly the panel data regression. In parallel with previous studies of corporate governance (Bhasin, Makarov, & Orazalin, 2012; Thomas & Boolaky, 2009), the regression analysis is used to investigate the relationship of a dependent variable from a number of independent variable (Coakes, Steed, & Ong, 2009). Moreover, the panel data regression is a good tool to repeat the observation of the same variables for several times periods (Pesaran, Shin, & Smith, 2000). The proxies that are used for corporate governance as independent variables are Board Size (BDS), Board Independence (BIND), CEO Status (CEOS), Audit Committee Size (ACS), Audit Committee Independence (ACIND) and Ownership Concentration (OWNCON), while dependent variables are ROA, ROE and Tobin's Q which are used as proxies for the financial performance. Both Bank Size (SIZE) and Leverage Ratio (LEVG) are used as control variables. The following regression models are developed:

1)

$$ROA_{it} = \beta_0 + \beta_1 BDS_{it} + \beta_2 BIND_{it} + \beta_3 CEOS_{it} + \beta_4 ACS_{it} + \beta_5 ACIND_{it} + \beta_6 OWNCON_{it} + \beta_7 SIZE_{it} + \beta_8 LEVG_{it} + e_t$$

2)

$$ROE_{it} = \beta_0 + \beta_1 BDS_{it} + \beta_2 BIND_{it} + \beta_3 CEOS_{it} + \beta_4 ACS_{it} + \beta_5 ACIND_{it} + \beta_6 OWNCON_{it} + \beta_7 SIZE_{it} + \beta_8 LEVG_{it} + e_t$$

3)

$$Tobin's Q_{it} = \beta_0 + \beta_1 BDS_{it} + \beta_2 BIND_{it} + \beta_3 CEOS_{it} + \beta_4 ACS_{it} + \beta_5 ACIND_{it} + \beta_6 OWNCON_{it} + \beta_7 SIZE_{it} + \beta_8 LEVG_{it} + e_t$$

The following are the details of the variables that are used in the regression models:

BDS = Total number of members on the board.

BIND = Total number of independent directors on the board / Total number of the board members.

CEOS = Value zero (0) if the same person occupies the position of the chairman and CEO and one (1) for otherwise.

ACIND = Total number of independent directors on audit committee / Total number of audit committee members.

ACS = Total number of members on audit committee.

OWNCON = The aggregate ownership of shareholders holding at least five per cent of equity.

SIZE = Log of total assets.

LEVG = Total liabilities / Total assets.

Annual reports of the 11 Saudi banks are used to obtain all the information that is needed to calculate the above variables.

EMPIRICAL RESULTS

Descriptive Analysis of Data

Table 1 shows the descriptive statistics for the whole sample.

- The overall size of banks increased over the years 2009 and 2012. While the average size of banks was 10.85 in 2009, it increased to 11.01 in 2012.
- The leverage ratio of banks is quite high, it increased from 79% in 2009 to 84% in 2012. In 2009, the minimum leverage ratio was 10% for Alinma bank (the bank was established in May 2009).
- The size of the board varied in the range of 7 and 11 directors. The mean of board size is 9.91 and 9.55 in 2009 and 2012 respectively.
- Board independence percentage decreased from 67% in 2009 to 57% in 2012. Over these years, the highest and the lowest rate of board independence was in 2012 (36% and 100%).
- The chairman and CEO jobs for the majority of Saudi banks were held by different individuals. The CEO duality was found only in one bank in 2012.
- Audit committee size varied in the range of 3 and 5 members. The average of audit committee size increased from 3.7 in 2009 to 4.1 in 2012.
- The average of independent directors in audit committee decreased from 82% in 2009 to 78% in 2012. In 2012, the level of audit committee independence ranged from a low of 33 per cent to a high 100 per cent in some banks.
- The range of ownership concentration widely differed within the banks. The mean of ownership concentration decreased from 56% in 2009 to 52% in 2012. The maximum level of ownership concentration was 79% in 2009, whereas the minimum level was 17% in 2012.

- There are four groups of ownership in banks in Saudi Arabia, namely, family, local investors, government and foreign investors. In 2009 and 2012, the mean of ownership concentration between groups remain generally stable over these years. Government ownership was the biggest group of ownership (mean \approx 20%), followed by foreign investors (mean \approx 16%). While local investors represented 12% of ownership in banks, family had the lowest level of ownership (mean \approx 6%).

Table 1 Corporate Governance Disclosure Index (CGDI)

CGD No.	Statements	Level of Compliance					
		2006		2009		2012	
		N	%	N	%	N	%
1. RIGHTS OF SHAREHOLDERS AND THE GENERAL ASSEMBLY		76%		80%		82%	
1.1 Shareholders Rights related to the General Assembly		90%		90%		91%	
1.1.1	A General Assembly is convened once a year at least within the six months following the end of the bank's financial year.	10	100%	11	100%	11	100%
1.1.2	Date, place, and agenda of the General Assembly is be specified and announced by a notice, at least 20 days prior to the date the meeting.	10	100%	10	91%	10	91%
1.1.3	Invitation for the General Assembly is published in the Exchange' website, the bank's website and in two newspapers of voluminous distribution in the Kingdom.	10	100%	11	100%	11	100%
1.1.4	Shareholders are informed about the rules governing the meetings and the voting procedure.	10	100%	11	100%	11	100%
1.1.5	Arrangements are made in the appropriate place and time of the general Assembly and communicated.	10	100%	11	100%	11	100%
1.1.6	The General Assembly's agenda is prepared by the Board of Directors.	10	100%	11	100%	11	100%
1.1.7	Shareholders are entitled and discussed matters listed in the agenda of the General Assembly and raise relevant questions to the board members.	10	100%	11	100%	11	100%
1.1.8	The board presents sufficient information to enable shareholders to make decisions.	10	100%	11	100%	10	91%
1.1.9	Shareholders have access to the minutes of the General Assembly, the bank provides Capital Market Authority with a copy of those minutes within 10 days of the convening date of a meeting.	10	100%	11	100%	11	100%
1.1.10	The Stock Exchange is immediately informed of the results of the General Assembly.	0	0%	1	9%	3	27%

1.2	Voting Rights		50%		50%		52%
1.2.1	Voting is exercise by shareholders.	10	100%	11	100%	11	100%
1.2.2	The accumulative voting method is applied for the nomination to the board members.	0	0%	0	0%	1	9%
1.2.3	Shareholders are informed about the attendance policy of the general Assembly.	10	100%	11	100%	11	100%
1.2.4	Investors who are judicial persons and who act on behalf of others disclose in their annual reports their voting policies, actual voting and ways of dealing with any material conflict of interests.	0	0%	0	0%	0	0%
1.3	Dividends Rights of Shareholders		60%		86%		100%
1.3.1	The Board of Directors have a clear policy regarding dividends.	3	30%	8	73%	11	100%
1.3.2	The General Assembly approves the dividends and the date of distribution.	9	90%	11	100%	11	100%
2.	DISCLOSURE IN THE BOARD OF DIRECTORS' REPORT		43%		84%		100%
2.1	The annual report contains details of Regulations as well as the provisions which have not been implemented, and the justifications for not implementing them.	2	20%	9	82%	11	100%
2.2	Disclose of the names of any joint stock companies in which the bank Board of Directors member acts as a member of its Board of directors.	6	60%	10	91%	11	100%
2.3	Details about executive board member, non-executive board member, or independent board member are given.	3	30%	10	91%	11	100%
2.4	A brief description of the jurisdictions and duties of the Board's main committees such as the Audit Committee, the Nomination and Remuneration Committee is done.	3	30%	11	100%	11	100%
2.5	Discloser of the details of compensation and remuneration paid to the chairman and members of the Board of Directors, the Top Five executives who have received the highest compensation and remuneration from the bank (The CEO and the chief finance officer are included if they are not within the top five).	8	80%	11	100%	11	100%
2.6	Disclose of the past penalty or preventive restriction imposed on the bank by the Authority or any other supervisory or regulatory or judiciary body.	2	20%	4	36%	11	100%
2.7	Results of the annual audit of the effectiveness of the internal control procedures of the bank are included in the published annual report.	6	60%	10	91%	11	100%

3. BOARD OF DIRECTORS		31%	54%	74%		
3.1 Main Functions of the Board of Directors		32%	36%	58%		
3.1.1	The board approves the strategic plans and main objectives of the bank.	6	60%	7	64%	8 73%
3.1.2	The board lays down a comprehensive strategy for the bank, the main work plans and the policy related to risk management, reviewing and updating of such policy.	3	30%	5	45%	10 91%
3.1.3	The board decides the performance objectives to be achieved and supervising the implementation thereof and the overall performance of the bank.	3	30%	4	36%	8 73%
3.1.4	The board reviews and approves the organizational and functional structures of the bank on a periodical basis (Budget).	3	30%	3	27%	3 27%
3.15	The board lays down rules for internal control systems and supervising them.	7	70%	9	82%	11 100%
3.16	The board develops 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.	0	0%	0	0%	3 27%
3.1.7	The board ensures the integrity of the financial and accounting procedures including procedures related to the preparation of the financial reports.	5	50%	7	64%	11 100%
3.1.8	The board ensures the implementation of control procedures appropriate for risk management by forecasting the risks that the bank could encounter and disclosing them with transparency.	7	70%	9	82%	11 100%
3.1.9	The board reviews annually the effectiveness of the internal control systems.	8	80%	9	82%	11 100%
3.1.10	The board drafts a Corporate Governance Code for the bank that does not contradict the provisions of this regulation, supervises and monitors in general the effectiveness of the code and amends it whenever necessary.	0	0%	1	9%	4 36%
3.1.11	The board lays 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.	0	0%	1	9%	6 55%

3.1.12	The policy includes mechanisms for settlement of complaints or disputes that might arise between the bank and the stakeholders.	0	0%	1	9%	3	27%
3.1.13	The policy includes suitable mechanisms for maintaining good relationships with customers and suppliers and protecting the confidentiality of information related to them.	2	20%	0	0%	2	18%
3.1.14	The Board of Directors lays down procedures for supervising the code of conduct for the bank's executives and employees compatible with the proper professional and ethical standards, and regulates their relationship with the stakeholders, and ensures compliance there with.	1	10%	1	9%	1	9%
3.1.15	The policy includes the Bank's social contributions.	6	60%	5	45%	7	64%
3.1.16	The board decides policies and procedures to ensure the bank's compliance with the laws and regulations and the bank's obligation to disclose material information to shareholders, creditors and other stakeholders.	0	0%	2	18%	3	27%
3.2	Responsibilities of the Board		50%		55%		68%
3.2.1	The bank's Board of Directors assume all the necessary powers for the bank's management.	4	40%	4	36%	6	55%
3.2.2	The executive management submits to the Board of Directors periodic reports on the exercise of the delegated powers.	6	60%	8	73%	9	82%
3.3	Formation of the Board		60%		92%		95%
3.3.1	The Articles of Association specifies the number of the Board of Directors members, provided that such number shall not be less than three and not more than eleven.	9	90%	11	100%	11	100%
3.3.2	The General Assembly appoints the members of the Board of Directors for the duration provided for in the Articles of Association of the bank, provided that such duration shall not exceed three years.	9	90%	11	100%	11	100%
3.3.3	The majority of the members of the Board of Directors are non-executive members.	4	40%	11	100%	11	100%
3.3.4	The Chairman of the Board of Directors does not hold any other executive position in the bank.	6	60%	11	100%	10	91%
3.3.5	The independent members of the Board of Directors shall not be less than two members, or one-third of the members, whichever is greater.	4	40%	11	100%	11	100%

3.3.6	On termination of membership of a board member the bank promptly notifies the CMA and Tadawul and specifies the reasons for such termination.	5	50%	8	73%	10	91%
3.3.7	No member of the Board of Directors serves more than five joint stock companies at the same time.	5	50%	8	73%	9	82%
3.4	Committees of the Board		37%		91%		100%
3.4.1	The formation of committees is per 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.	5	50%	10	91%	11	100%
3.4.2	The Board approves the by-laws of all committees of the Board, including, the Audit Committee, Nomination and Remuneration Committee.	1	10%	9	82%	11	100%
3.4.3	Number of non-executive members as Audit, Nomination and Remuneration Committee.	5	50%	11	100%	11	100%
3.5	Audit Committee (AC)		28%		47%		74%
3.5.1	The AC members shall not be less than three, including a specialist in financial and accounting matters.	7	70%	11	100%	11	100%
3.5.2	The General Assembly of shareholders issues rules for appointing the members of the AC and define the term of their office and the procedure to be followed by the Committee.	0	0%	1	9%	2	18%
3.5.3	Audit committee supervises the bank's internal audit department to ensure its effectiveness in executing the activities and duties specified by the Board of Directors.	7	70%	9	82%	10	91%
3.5.4	Audit committee reviews the internal audit procedure and prepare a written report on such audit and its recommendations with respect to it.	4	40%	7	64%	11	100%
3.5.5	The AC reviews the internal audit reports and pursue the implementation of the corrective measures in respect of the comments included in them.	2	20%	4	36%	10	91%
3.5.6	The AC recommends to the Board of Directors the appointment, dismissal and the Remuneration of external auditors.	2	20%	6	55%	11	100%
3.5.7	The AC supervises 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.	3	30%	7	64%	9	82%

3.5.8	The AC reviews together with the external auditor the audit plan and make any comments thereon.	1	10%	1	9%	4	36%
3.5.9	The AC reviews the external auditor's comments on the financial statements and follow up the actions taken about them.	1	10%	2	18%	5	45%
3.5.10	The AC reviews the interim and annual financial statements prior to presentation to the Board of Directors; and to give opinion and recommendations with respect thereto.	3	30%	5	45%	8	73%
3.5.11	The AC reviews the accounting policies in force and advice the Board of Directors of any recommendation regarding them.	1	10%	4	36%	8	73%
3.6	Nomination and Remuneration Committee (NRC)		0%		49%		80%
3.6.1	The Board of Directors sets up a committee to be named "Nomination and Remuneration Committee".	0	0%	10	91%	11	100%
3.6.2	The General Assembly, upon a recommendation of the Board of Directors, issues rules for the appointment of the members of the NRC terms of office and the procedure to be followed by such committee.	0	0%	5	45%	7	64%
3.6.3	The NRC recommends to the Board of Directors appointments to membership of the Board.	0	0%	7	64%	9	82%
3.6.4	The NRC annually reviews 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.	0	0%	6	55%	8	73%
3.6.5	The NRC regular reviews the structure of the Board of Directors and recommend changes.	0	0%	4	36%	8	73%
3.6.6	The NRC determines the points of strength and weakness in the Board of Directors and recommend remedies that are compatible with the bank's interest.	0	0%	2	18%	10	91%
3.6.7	The NRC ensures 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 bank.	0	0%	3	27%	6	55%
3.6.8	The NRC draws clear policies regarding the indemnities and remunerations of the Board members and top executives.	0	0%	6	55%	11	100%
Overall Level of Compliance with the CGRs			42%		63%		78%

Regression Analysis

Table 2 Descriptive Analysis

Variables	N	Min	Max	Mean	Std. Deviation	Skew	Kurtosis
2006							
BDS	9	8.00	11.00	9.55	.88	-.21	.14
BIND	6	.50	.88	.71	.14	-.50	-.77
CEOS	9	0.00	1.00	.77	.44	-1.62	.73
ACS	8	3.00	6.00	3.37	1.06	2.82	8.00
ACIND	8	.67	1.00	.87	.17	-.64	-2.24
OWNCON-Family	1	0.00	0.00	0.00	0	0	0
OWNCON-Government	1	.08	.08	.08	0	0	0
OWNCON- Local Investors	1	.20	.20	.20	0	0	0
OWNCON-Foreign investors	1	.40	.40	.40	0	0	0
OWNCON - Total	1	.68	.68	.68	0	0	0
Size	10	10.05	11.09	10.72	.35	-1.16	.24
LEVG	10	.73	.91	.84	.06	-1.14	-.05
2009							
BDS	11	9.00	11.00	9.90	.70	.12	-.45
BIND	11	.56	.89	.67	.11	.94	-.33
CEOS	11	1.00	1.00	1.00	0.00	0	0
ACS	11	3.00	5.00	3.72	.90	.64	-1.54
ACIND	11	.33	1.00	.82	.22	-1.08	.38
OWNCON-Family	9	0.00	.33	.07	.11	1.80	2.50
OWNCON-Government	9	0.00	.50	.19	.19	.90	-.69
OWNCON- Local Investors	9	0.00	.55	.12	.17	2.01	4.53
OWNCON-Foreign investors	9	0.00	.40	.17	.19	.30	-2.37
OWNCON - Total	9	.30	.79	.55	.16	-.22	-1.11
Size	11	10.24	11.27	10.85	.39	-.60	-1.18
LEVG	11	.10	.90	.79	.23	-3.24	10.64
2012							
CGD	11	.66	.91	.78	.08	-.14	-1.47
BDS	11	7.00	11.00	9.54	1.21	-.94	.65
BIND	11	.36	1.00	.56	.18	1.16	2.00
CEOS	11	0.00	1.00	.90	.30	-3.31	11.00
ACS	11	3.00	5.00	4.09	.94	-.20	-2.06
ACIND	11	.33	1.00	.77	.21	-.66	.01
OWNCON-Family	11	0.00	.36	.06	.12	2.00	2.86
OWNCON-Government	11	0.00	.53	.20	.19	.74	-.98
OWNCON-Local Investors	11	0.00	.23	.11	.09	.03	-1.77
OWNCON-Foreign investors	11	0.00	.40	.14	.18	.66	-1.76
OWNCON - Total	11	.17	.72	.52	.18	-.59	-.85
Size	11	10.47	11.43	11.00	.31	-.32	-1.25
LEVG	11	.69	.90	.84	.055	-2.52	7.48

As table 2 demonstrates, the study uses ROA, ROE and Tobin's Q as dependent variables, and BDS, BIND, CEOS, ACS, ACIND and OWNCON as independent variables, with using both the size (SIZE) and the leverage ratio (LEVG) as control variables.

The result of model with ROA shows that board size and board independence are significantly positively associated with ROA at 5% and 10% level of significance respectively. This implies that ROA increases as the board becomes bigger and more independent. However, there is no relationship between the other independent variables and ROA. The control variables size and LEVG are significant at 10% level and 1% level respectively. While the size has a positive relationship with ROA, LEVG has a negative association with ROA. The coefficient of determination (R^2) of this model indicates that about 67% of change in ROA is accounted for by the explanatory variables while the adjusted R square of 43% further justifies this effect. The value of F-statistics is significance at 5% level. The estimated regression model is:

$$\begin{aligned} ROA_{it} = & -0.138 + 0.005BDS_{it} + 0.021BIND_{it} + 0.010CEOS_{it} + 0.002ACS_{it} - 0.004ACIND_{it} \\ & - 0.009 OWNCON_{it} + 0.011SIZE_{it} - 0.037LEVG_{it} \end{aligned}$$

The result of model with ROE indicates that board size has a strong positive relationship with ROE at 1% level of significance. This implies that, an increase in the board size guarantees an increase in the performance of the banks. In addition, the result indicates that ownership concentration is significantly negatively associated with ROE at 10% level. The other independent variables do not have statistically significant relationship with ROE. The control variable size is positively significantly correlated with ROE at the 10% significance level. The coefficient of determination (R^2) of this model indicates that about 67% of change in ROE is predictable from the independent variables, while the adjusted R square is about 43%. The value of F-statistics is 2.776 with p-value of 0.05. The estimated regression model is:

$$\begin{aligned} ROE_{it} = & -1.363 + 0.045BDS_{it} + 0.156BIND_{it} + 0.059CEOS_{it} + 0.008ACS_{it} - 0.079ACIND_{it} \\ & - 0.115 OWNCON_{it} + 0.089SIZE_{it} + 0.031LEVG_{it} \end{aligned}$$

The result of model with Tobin's Q shows that board size has significant positive association with Tobin's Q at 1% level of significance, while ownership concentration has a significant negative relationship with Tobin's Q at 10% level. This implies that while Tobin's Q increases as the board becomes bigger, Tobin's Q decreases as the ownership concentration increases. Other independent variables do not have significant relationship with Tobin's Q. In respect to the control variables, while size is positively significantly correlated with Tobin's Q at the 10% significance level, LEVG has a significant negative relationship with Tobin's Q at 5% level. The

coefficient of determination (R^2) of this model is 62% and the value of F-statistics is significant at 0.05% level. The estimated regression model is:

$$\text{Tobin's } Q_{it} = -0.735 + 0.073\text{BDS}_{it} + 0.220\text{BIND}_{it} + 0.104\text{CEOS}_{it} + 0.031\text{ACS}_{it} - 0.070\text{ACIND}_{it} \\ - 0.195\text{OWNCON}_{it} + 0.107\text{SIZE}_{it} - 0.318\text{LEVG}_{it}$$

To sum up the results of the regression analysis, board size is the only corporate governance variable that has a significant positive relationship with all the financial performance measures (ROA, ROE and Tobin's Q). The analysis also shows that board independence has a significant positive association with ROA, whereas ownership concentration related negatively with ROE and Tobin's Q. However, the other independent variables do not have any significant relationship in any models. In respect to the control variables, bank size has a significant positive association with ROA, ROE and Tobin's Q, while leverage ratio has a significant negative relationship with ROA and Tobin's Q.

DISCUSSION

This section discusses the findings related to the relationship between different corporate governance variables and banks' financial performance. The study uses regression analysis and develops different regression models to investigate the relationship between these variables.

Board Size and Banks' Financial Performance

The study reveals that there is a strong positive relationship between board size and banks' financial performance. This implies that banks with large board size achieve a higher level of financial performance in terms of ROA, ROE and Tobin's Q, than those banks with small board. This finding is consistent with the previous studies that reveal a positive relationship between board size and the performance of a bank (Andres & Vallelado, 2008; Dalton & Dalton, 2005; Kyereboah & Biekpe, 2006; Stepanova & Ivantsova, 2012). This result is supported by the view of Adams and Mehran (2003), that large and universal institutions with multi-member boards of directors such as banks improves the financial performance.

On the other hand, this result is inconsistent with the finding of a study by Staikouras et al. (2007) to investigate 58 large European banks which shows a negative relationship between a board size and bank's financial performance. This inconsistency may result from the differences in the study context as banks in developed markets have different characteristics from the banks in developing markets which can result in a different type of relationship between board size and banks' profitability.

Board Independence and Banks' Financial Performance

The findings show that board independence is significantly positively associated only with ROA. This finding is in line with previous studies that reveal a positive relationship between the degree of board independence and bank's performance measured as ROA (Busta, 2008; John & Senbet, 1998; Pathan et al., 2007). Theoretically, this result is supported by the agency theory, which recommends that boards should have a majority of independent directors in order to protect shareholders' interests and improve the financial performance (Jensen, 1993).

The CEO Status and Banks' Financial Performance

The study reveals that there is no relationship between the separation of the positions of CEO and chairman and banks' financial performance measured by ROA, ROE and Tobin's Q. This finding is consistent with the findings of previous studies which reveal that the position of CEO and chairman of the board is not related to banks' financial performance measured as ROA and Tobin's Q (Arouri et al., 2011; Chen, Lin, & Yi, 2008; Pandya, 2011).

Audit Committee Size and Banks' Financial Performance

The findings indicate that audit committee size and banks' financial performance (ROA, ROE and Tobin's Q) are not related. This result is confirmed by previous studies which reveal that there is no significant relationship between audit committee size and financial performance. It is also consistent with the finding of a study by (Ahmed & Courtis, 1999; Brown & Caylor, 2006).

Audit Committee Independence and Banks' Financial Performance

The study shows that there is no relationship between audit committee independence and banks' financial performance in terms of ROA, ROE and Tobin's Q. This finding is in line with a study of Brown and Caylor (2006) which reveals that there is no relationship between audit committee independence and performance.

On the other hand, the result is inconsistent with the finding of a study by Aldamen et al. (2012) that audit committee independence improves the quality of financial reporting which in turn leads to better financial performance. This inconsistency can be explained based on the argument raised by Ezzamel and Watson (2005) that the effectiveness of independent directors depends on their knowledge and experience.

Accordingly, this result can be attributed to the fact that independent directors in audit committee in Saudi Arabian banks lack the appropriate skill and experience and thus their role in this committee is not effective (Al-Moataz, 2003).

Ownership Concentration and Banks' Financial Performance

The results indicate that ownership concentration has a significant negative relationship with banks' financial performance in terms of ROE and Tobin's Q. This result is in line with the finding of a study conducted by Arouri et al. (2011) which reveal negative impact of ownership concentration on banks' performance in the GCC countries. It is also consistent with the findings of previous studies that show the same relationship (Busta, 2008; Micco et al., 2007; Pinteris, 2002; Zeitun & Tian, 2007).

On the other hand, this result is inconsistent with agency theory argument of the positive impact of ownership concentration. The negative impact of ownership concentration on Saudi banks' performance may indicate that there is a conflict between large shareholders' interest and minority shareholders' interest. According to (Florackis, 2008), the conflict between large shareholders' interest and minority shareholders' interest results in poor bank performance. The negative impact of ownership concentration on Saudi banks' performance in terms of Tobin's Q can also be attributed to the inefficiency of the Saudi Stock Market as Tobin's Q is subject to inherent market anomalies such as price fixing and insider trading which are common in emerging markets such as Saudi market. Thus, these factors could have resulted in the negative relationship observed in this study.

Banks Size and Banks' Financial Performance

The finding of this study shows a strong positive correlation between board size and the performance of the banks in Saudi Arabia in terms of ROA and ROE and Tobin's Q. This finding is consistent previous studies that show the same relationship (Fallatah & Dickins, 2012; Pervan & Višić, 2012; Tzelepis & Skuras, 2004; Velnampy & Nimalathan, 2010; Zeitun & Tian, 2007). This result can be attributed to the fact that large banks have enough capital which allows them to expand their business operations to new activities, and thus improves bank diversification performance and lowers the concentration risk. In addition, large banks in Saudi Arabia are better equipped to use the new technologies and exploit the resulting cost savings and efficiency gains.

Leverage Ratio and Banks' Financial Performance

The study reveals that leverage ratio and banks' financial performance have a significant negative relationship. This finding is in line with the findings of a recent study investigating Saudi firms by Fallatah and Dickins (2012) which reveals that firms with low level of leverage have better performance than firms with high level of leverage. This finding is also consistent with previous studies that show the same relationship (Manawaduge, 2012; Rashid, 2008). The

reason behind this result could be that debt exposes banks to a higher risk through refinancing and capital commitment costs which reduce firm performance.

CONCLUSIONS

There are some limitations to this study. Since this study focuses only on the banking sector, the findings cannot be applied to other sectors in Saudi Arabia. In addition, the study excludes some items of the analysis due to the unavailability of information or data which would require the use of surveys or interviews to be obtained. Only published archival secondary data has been used.

The study contributes to corporate governance literature focusing on the banking sector in Saudi Arabia (an emerging country). The study provides a comprehensive view of the impact of corporate governance on the financial performance of banks in Saudi Arabia. The results indicate that both board size and bank size have a significant positive relationship with banks' financial performance measured as ROA, ROE and Tobin's Q. The analysis also shows that board independence has a significant positive association with ROA, whereas ownership concentration related negatively with ROE and Tobin's Q. In addition, leverage ratio has a significant negative relationship with ROA and Tobin's Q.

According to the findings of this study, there are some recommendations are suggested. First, bank should have a large board (between 9 to 11 members) as it contributes to better financial performance. Second, independent directors especially in audit committee should be qualified and have sufficient skills and experience relating to the banking industry.

LIMITATIONS OF THE STUDY

There are some limitations to this study. Since this study focuses only on banking sector, the findings cannot be generalized to other sectors in Saudi Arabia. In relation to financial performance, the study uses three different measures of financial performance and other measures which may show different results eg market to book value ratio have not been used.

There are many areas that have not been investigated in this study that may be useful for further study in Saudi Arabia. Future research is needed to examine the behavioural aspects of boards. Investigating areas such as board remuneration, board meeting and board dynamics would help gain a better understanding of corporate governance. This research can be also extended to cover aspects of the impacts of ownership concentration on financial performance by investigating the impact of each types of ownership. In addition, further research can be extended to cover corporate governance practices in different Arab countries in order to provide more insights into corporate governance practices in emerging countries.

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