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Factors Influencing Corporate Governance Disclosures: Evidence From Saudi Listed Companies

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Abstract

The purpose of this paper is to assess the level of Corporate Governance Disclosure (CGD) among publicly listed companies in Saudi Arabia and to identify the determinants of the CGD. The following corporate governance mechanisms, namely: board size, board independence, board meeting frequency, board qualification and managerial ownership, were regressed against the disclosure index developed by this study consistent with previous studies. Relevant data were extracted from the 2016 annual reports of sampled Eighty (80) non-financial publicly listed companies on the Saudi Securities Market (SSM). Using multiple regression analysis, the result obtained from the study's analysis revealed that none of the independent variables is significantly related to the disclosure index. The study's finding has important regulatory and managerial implications. It revealed a weakness in corporate governance compliance among Saudi listed companies.

Keywords: Saudi Arabia, corporate governance disclosure, the board size, board independence, managerial ownership

1. INTRODUCTION

The agency theory remains the most relevant theory to explain the corporate governance framework. According to the agency theory, agency cost arises due to the divergence of interest arising from the separation of ownership from control. (Jensen & Meckling, 1976). The shareholders, referred to as the principal, appoints the manager (i.e. the agent) to manage their affairs on their behalf. In this regard, managers may decide operating decisions to maximise their utility instead of increasing shareholders' welfare (Jensen & Meckling, 1976).

Consequently, there is information asymmetry whereby managers tend to withhold information from shareholders to maximise their utility and reduce the bonding cost. To ensure that managers act consistently with the interest of the shareholders, companies establish strong and effective corporate governance mechanisms. Corporate governance explains the procedures established to ensure that capital suppliers to corporations ensure a return on their investment.

Gillan and Starks (1998) defined "Corporate governance as the system of laws, rules, and factors that control the company's operations". It involves a set of relationships between a company's management, its board, its shareholders and other stakeholders. It provides a framework to establish its objective and realise the set objectives through monitoring. This study aims to identify the extent of Corporate Governance Disclosure (CGD) and identify those corporate governance mechanisms that determine the CGD among non-financial publicly listed companies on the Saudi Security Market.
The background of corporate governance and disclosure reforms in Saudi Arabia is informed using the country's data. Moreover, Saudi Arabia has the largest market economy among the countries in the Middle East (Alsaeed, 2006). At the end of the twentieth century, economic development and reform had become Saudi Arabia's primary

goal. Saudi Arabia has witnessed several reforms in governance. In the year 2000, the internal control system received special regulatory attention. The regulation issued in 2000 required all listed companies to design their internal control system based on these internal control standards (Al-Thuneibat et al., 2015).

Similarly, the year 2006 witnessed the issuance of a new code of corporate governance, which compliance was mandatory for all Saudi listed companies in 2010 (Alzahrani, 2013). According to reporting reforms, one of the earlier accounting standards issued in Saudi Arabia was the standard of disclosure and transparency. The Ministry of Commerce and Industry issued this in 1985. The standard was updated by the Saudi Organization for Certified Public Accountants (SOCPA) in 2002. Another disclosure reform is the country's commitment to fully adopting International Financial Reporting Standards (IFRS) by 2017. IFRS adoption intends to ensure transparent and high-quality reporting practices.

In summary, governance and disclosure reforms in Saudi Arabia have been good to a certain extent. However, non-financial disclosure requirements in Saudi Arabia rules are still weak due to some critical aspects of information, such as CG - related information (World Bank, 2009). The paper is organised as follows. The following section briefly considers CG disclosure policy reforms in Saudi Arabia. The following sections present the theoretical framework, review the empirical literature, develop hypotheses, outline the research methodology, and discuss the paper's findings. The concluding remarks of the article are provided in the final section.

2. LITERATURE REVIEW

2.1 Corporate governance, disclosure policy reforms and the Saudi Arabia corporate

Saudi Arabia is the largest country in the Arabian Peninsula and the most significant market economy among the Arabian countries, holding 25 per cent of the total Arab gross domestic product (Alsaeed, 2006). The abundant oil reserve has enormously contributed to the gross national product and allowed the Saudi government to increase investment activity. At the end of the twentieth century, economic development and reform were of significant concern to the Saudi Arabian government. These are prominent among government organisations' recent privatisation changes, such as Saudi Telecom Company and National Company for Cooperation Insurance, and Saudi Basic Industries (SABIC) (Alsaeed 2006). This started with particular attention being given to internal control systems. Thus, Saudi standard-setters issued internal control standards in 2000. Saudi companies must design their internal control system based on these internal control standards (Al-Thuneibat et al., 2015). CG codes were also issued in 2006, which became compulsory for all Saudi-listed companies in 2010 (Alzahrani, 2013). Previous studies have changed how board characteristics, audit committees, and managerial ownership influence corporate governance disclosure. This depends on the legal and regulatory environment levels aimed at protecting investors and other stakeholders in the firm and other factors such as sample variation and methodology. Here, we can distinguish between two trends in previous studies.

2.2 Board Size and Corporate Governance Disclosure

Board size plays a significant role in making internal governance mechanisms more effective. According to agency theory, the board of directors is an essential monitoring mechanism that monitors the reporting behaviour of management by ensuring a high level of disclosure ((Allegrini & Greco, 2013; Davidson, Nemec & Worrell, 1996), and the size of the board is the essential element in monitoring management behaviour. Past literature argued that large boards are more effective because of diversity in their expertise, backgrounds, and abilities, which can help the board provide adequate and transparent disclosure of information (Pearce & Zahra, 1992). Larger board size is recognised as showing variations in terms of the backgrounds, skills, and expertise that can generate ideas in providing high levels of disclosure (Brown, Beekes & Verhoeven, 2011).

The Saudi Code of Corporate Governance (SCCG) stipulates that the board should consist of a minimum of three directors and a maximum of eleven members. The board size requirement, as enshrined in SCCG provides flexibility to listed companies to decide the number of directors suitable for their operation size. Board size affects the overall capacity of the firm to operate efficiently. Smaller boards are commonly less efficient in obtaining vital resources, such as external funding (Goodstein, Gautam & Boeker, 1994). The companies may gain the flexibility to include productive directors as board members and suitable size as the best corporate governance practices. Consistent with previous studies (Byard, Lin & Weintrop, 2006), the study set the following hypothesis:

Hypothesis 1: There is a positive relationship between board size and the level of corporate governance disclosure.

2.3 Board of Independence and Corporate Governance Disclosure

The concept and criteria of independent directors have become more stringent with time. The SCCG (2006) Part four, Article 12, Paragraphs (C) and (E) centre on board independence, with Paragraph (C) stating that "The majority of the members of the Board of Directors shall be non-executive members". Furthermore, Paragraph (E) also noted that "The independent members of the Board of Directors shall not be less than two members or one-third of the members, whichever is greater". Accordingly, the board's non-independent directors could constitute two-thirds of the members (Al-Abbas, 2008; Combined Code, 2003). In recent times, boards independent have received much scrutiny regarding corporate governance regulations and academic research (Chen, Sun, Tang and Wu., 2011).

Prior empirical research has established a link between corporate disclosure and board independence. Forker (1992) examined and found a positive relationship between the number of outside directors and financial disclosure. In another paper, Laksamana (2008) reported a result similar to Forker (1992). Klein (2002) found that corporate managers were less likely to manage earnings and commit fraud if many non-executive directors were on boards. AlsoChen and Jaggi (2000); Gul and Leung (2004) argued that a high number of independent directors on boards leads to more effective board monitoring and higher levels of corporate transparency.

On the other hand, some empirical research established a negative relationship between outside directors on boards and levels of disclosure. Studies that reported this result include Eng and Mak (2003), Barako, Hancock, and Izan (2006) and Hoitash, Hoitash and Bedard (2009). Others found an insignificant association between the two variables (see, for example, Ho and Wong, 2001 and Haniffa and Cooke, 2002). Based on the above-mixed results, we aim to re-examine the relationship between corporate governance disclosure and board independence in Saudi Arabia. The study hypothesis:

Hypothesis 2: There is a negative relationship between board independence and the level of corporate governance disclosure.

2.4 Audit Committee Meetings and Corporate Governance Disclosure

Another essential board monitoring mechanism is the audit committee meeting frequency (Laksmana, 2008; Vafeas, 1999). Several Previous studies have commonly depended on audit committee meetings per year as a metric for the perseverance of the audit committee because different measures of effort are not publicly observable (DeZoort et al., 2002). High meeting frequency is an indication that the directors efficiently utilised their skills and time to the benefit of their company (Laksmana, 2008 and Vafeas, 1999). Regulators, commissions, and committees have recommended more frequent audit committee meetings in a year. For instance, for an influential audit committee, the Blue-Ribbon Committee (1999) and PwC (1993) suggested at least four meetings per year; similarly, KPMG (1999) proposed between three and four meetings per year. The result aligned with the Saudi Arabia Code of Corporate Governance (2006) that recommended an audit committee to hold a minimum of four meetings per year (Yin et al., 2012).

Various research and governance best practices reach a consensus on the effectiveness of audit committee proficiency in carrying out their task and mitigating agency problems (Jensen & Meckling 1976). The audit committee can influence management decisions when the choices are inconsistent with the board of directors (Al-Moataz, 2003). Kent et al. (2010); Kent and Stewart (2008) recognised that applying better corporate governance encourage high disclosure quality.

However, an opposite linkage might develop amid the audit committee's activities and the number of board meetings. Similarly, more frequent board meetings would prompt more audit committee actions (Adelopo et al., 2012). Hence from the above discussion, the following hypothesis is posited:

Hypothesis 3: There is a negative relationship between the number of the audit committee meeting and the level of corporate governance disclosure.

2.5 Audit Committee Qualification and Corporate Governance Disclosure

Corporate governance literature suggested that age, work experiences and educational qualifications are essential factors that impact the director's performance (Adawi & Rwegasira, 2011). Bushman et al. (2004) focused on specific attributes of directors, such as work experiences, educational qualifications, and marital status. Bushman et al. (2004) claimed that all these attributes affect board efficiency and effectiveness. Shehata (2016), Ball (2009) and Kothari (2001) also argued that work experiences and educational qualifications are among the most important determinants of board efficiency. For instance, the choice of the quality audit was found in previous literature as being dictated by the level of qualification and the professional experience of an audit committee member. A study conducted by Steel (1976) mentioned the strong relationship between the level of scientific and professional qualification and fees of the auditing process due to a relative increase in salaries of the highly qualified auditors compared to those of low qualification. Increase in the cost of the audit process due to continuous training for auditing teamwork(Al-sharari, 2009).

This code comprised six primary principals, and the selection of qualified directors was one of them (Shehata, 2015). Albassam (2014) and Soobaroyen and Mahadeo (2012) have argued that amendments in the Saudi code have stressed that companies should include qualified and professional members on board. Albassam (2014) continued that, in Saudi Arabia, size, culture, and the family ownership structure have significant impacts on the board's composition. However, they concluded that many companies adopt code provisions and add qualified professional directors. According to Casey et al. (1988), a large company is more likely to obtain qualified members because of a broader public vision. Hence, from the above discussion, the following hypothesis is posited:

Hypothesis 4: There is a negative relationship between board qualification and the level of corporate governance disclosure.

2.6 Managerial Ownership and Corporate Governance Disclosure

Managerial ownership is measured as the ratio of shares held by executive directors at the end of the fiscal year. The separation of ownership and management in modern corporations has led to a divergence in the interests of internal and external stakeholders. In this regard, debt and managerial ownership are argued to be effective governance mechanisms to converge these interests (Wahba, 2014). Managerial ownership is defined as the ratio of shares held by the executive directors to total authorised, issued capital. Arguments have been given in support and against. Shares ownership by executive directors can mitigate agency problems as it reconciles the interest of the management and that of the shareholders because the management sees themselves as one of the owners of the company (Jensen & Meckling, 1976). If managerial ownership falls, external shareholders will more frequently check the behaviour of managers (Jensen & Meckling, 1976). This is because managers are more aware than external stakeholders. Hence, managerial ownership is considered a strong signal about the company's quality, which, in turn, reduces information asymmetries (Leland & Pyle, 1977; Wahba et al., 2014). The opposing argument is supposed to raise agency problems due to the entrenchment effect.

The managerial ownership in Saudi listed companies has 45%. However, little or no attention has been given to the impact of managerial ownership on corporate disclosure practices in Saudi listed companies. This study extends the study of Al-Moataz and Lakhal (2012) by looking at managerial ownership other than other ownership. Based on the positive relationship established from prior literature, the following hypothesis is posited:

Hypothesis 5: There is a negative relationship between managerial ownership and the level of corporate governance disclosure.

3. METHODOLOGY

3.1 Data and Methods

The sample of this study consists of 80 companies listed on the Saudi Stock Exchange in the year 2016. Corporate governance data and companies' characteristics were collected from the annual reports and Tadawul database. This led to a sample of 80 companies' observations for the period under consideration. The following model is estimated to examine the factors influencing corporate governance disclosure among Saudi listed companies.

CGD=β0+β1BOARDSIZE+β2BODIND+β3ACMEET+β4ACQUALIFICATION+β5MANGOWSH+5

Table 1 Variable Definition

Variable Definition

CGD	Corporate Governance (CG), Compliance and Disclosure Index, consisting of 138 Provisions from The SCGC, which takes the value of 1 for each corporate governance provision disclosed, and 0 Otherwise. The total expected disclosure multiply scales the total number of disclosure by 100. Therefore, the disclosure index ranges between0% And 100%.
BOARD SIZE	The total number of directors serving on the board of directors.
BODIND	The number of independent non-executive directors on the board is scaled by board size.
ACMEET	The number of meetings organised by the audit committee.
AcQualification	. Measured by the number of directors in the audit committee with an academic qualification, professional qualification and work experience.
MANGOWSH	Percentage of shares owned by non-executive directors to the total number of shares issued.

4. RESULTS AND DISCUSSION

4.1 Descriptive Analysis

In table 1, the corporate governance disclosure level in Saudi companies was 56 per cent, which is high. However, it can be said that Saudi companies have a proper level of disclosure compared to companies in other developing and developed countries, such as Hong Kong, where the level of corporate governance disclosure was reported as 29 per cent (Ho& Wong, 2001), Malaysia as 31 per cent (Ghazali & Weetman, 2006) and Singapore as 29 per cent (Cheng & Courtenay, 2006). As shown in Table 2, the average number of directors on board is eight, consistent with the Saudi code of CG requirement, which requires boards of directors to have more than three members but not more than 11. Also, Table 2 reveals that most of the directors on board are independent directors with an average of 4 per cent. The result indicates that Saudi listed firms comply with the requirement of the SCCG, which requires that the majority of audit committee members should be independent directors and that the size of the audit committee should consist of at least three members. On average, the audit committee meets at least five times a year, which is above the SCCG requirement that audit committee members should meet at least three times a year. Concerning audit committee qualification, just 1 per cent of the audit committee member have a postgraduate degree. Finally, the average managerial ownership is 1.89 per cent. The average of managerial ownership revealed in Table 2 is consistent with the Saudi Arabia code of CG requirement.

Table: 2 Summary Statistics

VARIABLE	OBS	MEAN	STD	MIN	MAX
CGD	80	56.73	2.35	51	62
BOARDSIZE	80	8.25	1.45	5	12
BODIND	80	4.19	1.35	2	8
ACMEET	80	5.47	1.62	2	9
ACQUALIFICATION	80	0.70	6.60	0	2
MANGOWSH	80	1.89	5.53	0	30.99

BoardSize = Board Size, BODIND = Board Independence,
ACMEET = Audit Committee Meeting,
AuditQualification= TOTALM+ PhD, MANGOWSH = Managerial Ownership

4.2 Correlation Analysis

The relationship between the present study's variables was tested using Pearson Correlation analysis. The analysis revealed the absence of severe multicollinearity issues, with all of the variables a significant relationship not exceeding 40%. Moreover, the variance inflation factors (VIF) obtained did not exceed 10. Meanwhile, heteroscedasticity was tested for the variance behaviour using the Breausch-Pagan/Cook-Weisberg test. The results showed the absence of heteroscedasticity in data (chi2 (1) = 2.03, prob> chi (2) = 0.1542). To mitigate the extreme values bias, the entire variables were winsorized at 1% from top to bottom.

Table 3 Pearson correlation matrix

		1	2	3	4	5	5
1	CGD	1					
2	BOARDSIZE	0.17	1				
3	BODIND	-0.06	0.41	1			
4	ACMEET	0.13	0.06	-0.03	1		
5	ACQUALIFICATION	-0.04	-0.04	0.10	-0.08	1	
6	MANGOWSH	-0.12	0.03	-0.18	-0.01	0.12	1

BoardSize = Board Size, BODIND = Board Independence,
ACMEET = Audit Committee Meeting,
AuditQualification= TOTALM+ PhD, MANGOWSH = Managerial Ownership

4.3 Multivariate Regression Result

The results displayed in Table 4 provides evidence that board size is significantly positively related to CGD, consistent with the Saudi code of CG requirement, which requires boards of directors to have more than three members but no more than 11. The result is also consistent with the argument that a large board size can accommodate more directors with the required expertise and skill to improve their monitoring responsibility. Furthermore, as shown in Table 4, board independence indicates that board audit committee independence is significantly negative with CGD. The result is contrary to the expectation that the independent director's presence in the audit committee should improve the committee's monitoring responsibility and lead to more CGD. However, the study found no significant relationship between audit committee meetings and the CGD of the company.

Similarly, the result of the present study showed a positive but insignificant relationship between audit committee qualification and CGD. In contrast, the result for managerial ownership displayed in Table 4 is negative but insignificantly related to CGD. Most of the literature since Berle and Means (1932) argued that boards choose managerial ownership to help align managerially and shareholder interests' results reveal the interaction between managerial ownership and CGD is negative and insignificant. Due to managerial ownership diminishes board activity and specifically that managerial ownership negatively affects CGD.

Table:4 Summary Results of the Regression (N = 80)

Disclosure	Coef	Std	t	P>|t|
Board Size	0.370	0.167	2.22	0.30
BODIND	-0.330	0.172	-1.92	0.059
ACMEET	134.958	1271.687	0.106	0.292
Total MPHD	0.104	0.366	0.28	0.778
MangOwsh	-0.064	0.077	-0.83	0.411
_cons	54.342	1.549	35.09	0.000

6. SUMMARY AND CONCLUSION

The aim was to examine the relationship between corporate governance characteristics and disclosure level of corporate governance practice in Saudi Arabian's listed companies. The sample was 80 non-financial Saudi listed companies. The current review identified five key variables that were likely to influence disclosure by Saudi listed companies. This study has important implications for governments to be more effective in implementing best corporate governance practices. Additionally, findings board size and audit committee positively affect the disclosure, which indicates that corporate governance disclosure plays a role in disclosure effectiveness.

Furthermore, the study also found that board independence significantly and negatively affects corporate governance disclosure. At the same time, it audits committee qualification, and managerial ownership does not affect corporate governance disclosure. Hence board size and the audit committee are better than companies with the disclosure in applying the best practices of corporate governance to provide sufficient and high-quality disclosure. Finally, it is expected that future empirical studies with the non-conceptual framework can enhance corporate governance disclosure for users of financial and non-financial statements such as investors, creditors, shareholders and other stakeholders in Saudi and beyond.

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