

The Impact of Ownership Structure on Corporate Performance in Saudi Arabia: Additional Evidence

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Abstract

This study aims at investigating the associations of family ownership and domestic corporate ownership with corporate performance among listed companies in Saudi Arabia in 2013. The final sample in this study consists of 117 companies. The *OLS* regression shows that domestic corporate ownership is associated positively with corporate value. Further, the results of this study exhibit that there is no relationship reported between family ownership and corporate value in the context of Saudi Arabia. The results of this study are of importance to policy-makers at the country and company levels in terms of issues related to corporate value. Further, the additional empirical evidence provided by this study could be used by the future research to understand more about corporate performance issues in Saudi Arabia in particular and in other Arab countries in general.

Keywords: ownership structure, corporate performance, Saudi Arabia.

Introduction:

It is well documented that the issue of firm performance has been given an attention after the crises of the Asian, Russian Federations, and Brazil financial crisis that started in 1997, the failing of some companies in the United States such as Enron, Xerox, Worldcom, and Parmalat, and the Saudi Stock Exchange (Tadawul) crash in early 2006. Moreover, the separation and conflicts of interest between shareholders and managers in companies may lead to agency problems (Fama & Jensen, 1983; Jensen & Meckling, 1976). Importantly, solving the problems emerging from the crises and aligning shareholder and management interests, or reducing conflicts of interest, corporate governance has been well-documented that, will, consequently, lead to enhancing firm performance (Al-Abbas, 2008; Al-Hamidy, 2010; Al-Hussain, 2009; Al-Moataz & Basfar, 2010; Al-Twajiry, 2007). Ownership structure is recognized as having the most significant impact on CG systems (Solomon, 2011; Thomsen & Pedersen, 2000), as well as on firm value (Aljifri & Moustafa, 2007; Barclay & Holderness 1989; Demsetz & Lehn, 1985; Soliman, 2013). It has been noted by Hill and Snell (1988) that ownership structure amongst firms operating in the USA positively impact productivity as a performance measure. Based on the agency theory that expressed that "deals with the ways in which suppliers of finance to corporations assure themselves of getting a return on their investment" (Shleifer & Vishny, 1997). This

means that both institutional and market-based induce the self-interested controllers of a company (those that make decisions regarding how the company will be operated) to make decisions that maximize the value of the company to its owners (Denis & McConnell, 2003).

In the Middle East, family-owned and domestic corporate-owned companies are among the most dominant groups in the business market. These different types of ownership commonly have representatives on the board of directors of each company and, as a result, are well-positioned to gain access to internal data, which impacts the overall performance of the entity (Al-Shammari et al., 2008). Soliman (2013) recognizes ownership concentration in Saudi Arabia as having a positive impact on firm performance. Moreover, in Egypt, Abdel Shahid (2003) provides comparable finding to those established by Soliman (2013). In Saudi Arabia, companies are characterized as more concentrated where shares are held by the state and families as well as individuals. Despite the relatively free market economy employed by Saudi Arabia, with the predominance of the private sector, the primary public utilities and services are government-owned and controlled. But the stock market is dominated by family holdings, as 75 percent of the companies are family-owned (Al-Tonsi, 2003). This can be attributed to various factors. First, the majority of companies listed in Tadawul were originally owned by families before undergoing public initial offerings for listing. These companies are primarily managed by the founding families who were already rich

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and well established and who have been controlling the business for a significant number of years. Second, a few privileged families were noted to contribute to trade activities, while the rest of the population takes part in labor, which hardly produces a sufficient amount of income to satisfy their needs. The rest of the companies (25 percent) that are controlled by the government are owned by the individuals who started them (Al-Harkan, 2005).

This study will hopefully contribute to extending empirical research into family and domestic corporate ownerships with firm performance in Saudi Arabia, which is a special case, one hallmark of which is an institutional framework that clearly differs from that of its Anglo-Saxon counterparts. It may not, in fact, be wise to extrapolate empirical evidence from Anglo-Saxon markets to Saudi Arabia for several reasons: (1) Saudi Arabia has intervened heavily in linking legal origins and financial arrangements. It is still suffering from a lack of equity among investors. (2) The current corporate governance frameworks of Saudi Arabia does not meet the threshold sought by international investors (AL Majlis, The GCC Board Directors Institute, 2009). (3) Recently, however, Saudi Arabia has adopted and developed large-scale economic and market policies and strategies that convert them to market-oriented economies. In this case, these issues may have an influence on the firm performance issues in Saudi Arabia, and agency problems are more likely to arise between the majority and the minority of shareholders.

This study investigates the variation in the level of family and domestic corporate ownership and how such variation could influence the degree of firm performance in Saudi Arabia. The findings of this study should be of interest to policymakers in Saudi Arabia as well as to those emerging markets in the Middle East because of the similarities in the institutional and cultural environments and in the corporate ownership structure of firms (La Porta & Lopez-de-silanes, 1999). The results may also be of interest to other researchers who are investigating the firm performance issues and family and domestic corporate ownerships. Moreover, the results of this study will hopefully motivate further inquiries into why the family and domestic corporate ownerships vary according to the degree of firm values.

The remainder of the paper is organized as follows. Section 2 discusses the literature review

and development of hypotheses. Section 3 describes the data collection and research design. The results and discussions have been highlighted in section 4. And, the final section provides conclusions and implications.

Literature review and development of hypotheses:

The existence of family ownership with a long-term interest in the firm will restrict the potential of management to improve firm performance (Amran & Che-Ahmad, 2010; La Porta et al., 1999; McConaughy et al., 1998; Villalonga & Amit, 2006). This perspective is in line with agency theory, which suggests that concentrated ownership can result in a reduction in agency problems (Fama & Jensen 1983; Tosi et al., 1989). Moreover, family firms are managed by family members who have valuable elements such as altruism and trust, which can help to develop "an atmosphere of love for the business and a sense of commitment." Nepotism and favoritism are both regarded from the perspective of family businesses that seek success in the capital and product markets, and to compete in such. With the spirit of family, the family firms are controlled and monitored.

Research carried out by Chu (2011) and Mishra et al. (2001) highlight a positive link between founding family control and firm value. The results emphasize that the possible impacts of family ownership are more likely to be recognized when there is a combination of family ownership with active family control and management. Wiwattanakantang (2001) noted that controlling shareholder and family-controlled businesses can be linked with greater performance. However, firms operating in Arab countries are more likely to have concentrated ownership (INSEAD, The Business School for the World, 2010). Moreover, in GGC (such as Saudi Arabia) families hold, on average, between 19 percent and 30 percent of firm board seats (The National Investor Market Insight, 2008).

From the above discussion, it is illustrated that there is a link between family ownership and firm performance. The present study expects a direct association between family ownership and firm performance. The testable hypothesis is stated as follows:

H₁: Ceteris paribus, there is a positive relationship between family ownership and firm performance.

The growth of owners as largest shareholders in companies leads to decreased agency costs

(Jensen & Meckling, 1976), because these holdings in companies provide an evidence to support the view that company ownership delivers a number of important advantages to firms involved in specific business agreements by decreasing the costs of monitoring the ventures or alliances between firms and their corporate blockholders (Allen & Phillips, 2000; Claessens et al., 2000). In addition to this, the requirement of managing earnings needs to lessen contractual restrictions, which would stimulate and inspire controlling owners to enhance earnings informativeness.

Chhibber and Majumdar (1999); Djankov and Hoekman (2000); Khanna and Palepu (2000) suggested that greater degrees of resources—financial, organizational and technical—are delivered by domestic investors. In addition, the supervision roles of local investors are commonly impacted by local business and governmental relations and networks (Claessens

et al., 2000; Dharwadkar, George & Brandes, 2000; Douma et al., 2006).

Motivated by the above discussion, the present study expects a direct association between domestic corporate ownership and firm performance. The testable hypothesis is expressed in this expectation:

H₂: Ceteris paribus, there is a positive association between domestic corporate ownership and firm performance.

Data collection and research design:

3.1 Sample selection and data collection:

The population of interest comprises all non-financial listed companies on Saudi Stock Exchange (Tadawul) for the year 2013. This selection is the most recent test period for which data were available. Further, the boom of Saudi Arabia clearly emerged in early 2005 (Chahine & Tohme, 2009). A cross-sectional review of audit reports of the sample companies listed on the Saudi Stock Exchange was undertaken. Samples selected depicted are in Table 1.

Table 1 Sample Selection in 2013

	Totals
Total listed companies	145 company
Banks and financial services	(11)
Outliers	(7)
Missing and incomplete data	(10)
Final sample	117

The firm performance model used in this study is adapted from prior studies to accommodate the ownership structure and firm performance in Saudi setting. We include five profound control variables which have been empirically evidenced to be associated with firm performance. These variables are board of director size (*BD_SIZE*), board of director meetings (*BD_MEET*), firm size (*F_SIZE*) firm leverage (*LEV*), and firm age (*FAGE*).

In terms of the association of board of directors' size (*BD_SIZE*) and firm performance, the absolute number of directors is recognized as an essential aspect of efficient governance (Pearce & Zahra, 1992). The resource dependence theory supports the view that firms are afforded links to the outside environment. According to this theory, larger board of directors' size shows diversity in term of members' backgrounds, expertise, and skills, which can generate a greater abundance of ideas that can provide high levels of performance (Brown et al., 2011). The size of the board impacts its overall capacity to operate efficiently,

with smaller boards commonly is seen to be less efficient in terms of obtaining external funding, budget amount, and leverage from an environment which, in turn, will be associated by greater levels of firm performance, as highlighted by Alexander et al. (1993); Goodstein et al. (1994); and Pfeifer (1972, 1973). In line with this, the meta-analysis of Dalton et al. (1999) is seen to support the view that board size can be linked positively with firm performance. In the context of GCC countries, the board size of different companies ranges from 8.5 in Qatar to 6.7 in the UAE (Binder, 2009). As for local studies in the Saudi setting, Al-Abbas (2009) and Al-Ghamdi (2012) find that a larger board of directors is linked with lesser earnings management among Saudi-listed companies. Thus, the expected sign for the effect of board of directors' size on firm performance is positive based on the direction of the extant research.

With regard to the relationship of board of directors' meetings (*BD_MEET*), agency theory suggests that company boards show greater

capabilities in terms of advising, disciplining and monitoring management, and thus improving performance, when there is a greater frequency in board meetings (Vafeas, 1999; Jensen, 1993; Lipton & Lorsch, 1992). An empirical study conducted by Vafeas (1999) on a sample of 307 companies listed in the USA for the period 1990–1994 supports the view that boards meet more frequently following the occurrence of a crisis, which helps to improve performance. Furthermore, Karamanou and Vafeas (2005) clarified that the impact of board meetings on firm performance might vary not only in terms of firm-level characteristics, but also in terms of country-specific CG, and legal and institutional practices. A local study carried out by Al-Ghamdi (2012) found that there is a negative association between board meetings and earnings management in Saudi Arabia. This result is in line with the notion that a greater frequency of board meetings results in a greater degree of monitoring. Therefore, the expected sign for the effect of board of directors' meetings on firm performance is positive based on the direction of the extant research.

In terms of firm size (*F_{SIZE}*) and firm performance, it is indicated that larger firms are more effective than smaller ones that is because of the skills of staff, economies of scale, and market power (Helmich, 1977; Kumar, 2004). By the same way of token, Haniffa and Hudaib (2006) indicate that larger organizations have more analysts available who are centered on the performance of the firm and, as such, are under greater pressure to perform well. In addition, Pfeffer and Salancik (1978) document that the environment they work in is more influenced by larger firms than smaller ones. This situation creates an access to larger resources and fundamental constituencies in order to involve outside consultants for support in enabling the succession planning. Aljifri and Moustafa (2007) and Kumar (2004) find a positive link between firm performance and firm size. Thus, the expected sign for the effect of firm size on firm performance is positive.

As for the association of firm leverage (*LEV*) with firm performance, Agency theory conjectures that debt financing is more effective than equity (Jensen & Meckling, 1976). It is believed that leverage controls managers' incentive from wasting free cash flows and, consequently, it enhances the managers' motivation in improving the firm performance (Myers, 1990). Furthermore, debt financing applies aggressive market monitoring on

managers actions. For instance, Grossman and Hart (1982) document that debt financing makes managers aware of consuming fewer perks and become more efficient to avoid bankruptcy; the loss of control as well as loss of reputation. In contrary, Stiglitz and Weiss (1981) predict that as a firm is financed with large debts, it is more likely that its equity holders with limited liability may prefer to undertake highly risky projects and this might inverse with the firm performance. Previous studies on firm performance have resulted in contradictory results. For example, Downen (1995), McConnell and Servaes (1995), Short and Keasey (1999), Weir et al. (2002), Haniffa and Hudaib (2006) and Aljifri and Moustafa (2007) report a significant negative relationship between leverage and firm performance. However, Hurdle (1974) documents a positive association of the leverage with firm performance. Therefore, the expected sign for the effect of leverage on firm performance is negative based on the direction of the extant research.

As for the association of firm age (*F_{AGE}*) and firm performance, The age of the firm is a critical factor in firm development, firm dissolution likelihood, and the variability of business growth (Evans, 1987a). The link between firm performance and firm age has been detailed well, with some research utilizing age as a proxy for the experience a firm has gained through its business (Geroski, 1995). With the increase of firm age, management garners much more insight into their abilities and skills over time (Stinchcombe, 1965; Evans, 1987b). Younger firms are more vulnerable with firm age expected to last only between five and 10 years, as noted by Ward and Mendoza (1996). The main point to be made in this regard is that established approaches, organizational norms, and routines in older firms restrict the translation of entrepreneurial actions and activities into positive performance outcomes. This implies that longer-established entities may experience problems in overcoming age-related contextual factors, regardless of their implementation of a strategy-making approach that is otherwise encouraging in fulfilling positive firm development. In this study, therefore, there is a positive link between firm performance and firm age, measured as the number of years since the establishment of the company.

3.2 Regression model and definition of variables:

The economic model is used to develop a model

of firm performance. The variables proposed for inclusion in the model capture differences in the costs of agency relationships. The dependent variable is a continuous measurement. To estimate this model, Multivariate Analysis is applied using OLS regression because the dependent variable is a continuous nature.

Therefore, OLS regression analysis is used to estimate the associations proposed in the hypotheses. The functional equation of the OLS model is utilized to determine the extent of the influence of each of the independent variable on the firm performance:

$$FIRM_PERFORMANCE = \beta_0 + \beta_1 FAMILY_OWN + \beta_2 DOMESTIC_OWN + CONTROL\ VARIABLES + e \dots\dots\dots(1)$$

Where the dependent variable is:

$$FIRM_PERFORMANCE = \text{Return on Assets}$$

Where the independent variables are:

- FAMILY_OWN = percentage of 5 or more of the ordinary shares held by a family,
- DOMESTIC_OWN = percentage of 5 or more of the ordinary shares held by domestic corporations

Control variables

- BD_SIZE = the total number of directors sitting on the board,
- BD_MEET = the number of board meetings during the year,
- FSIZE = log₁₀ of the total assets,
- LEV = total debt to total assets,
- FAGE = the number of the years since the company is established till 2013,
- e = error term.

4. Results and discussions

4.1 Descriptive statistics and correlation analysis

Table 2 predicts the mean, standard deviation, minimum and maximum of each variable in the sample data set.

Table 2 Descriptive statistics (N = 117)

Panel A: Independent variables				
Variables	Mean	Std.Deviation	Minimum	Maximum
<u>Hypothesized variables</u>				
FAMILY_OWN	0.095	0.146	0	0.950
DOMESTIC_OWN	0.068	0.156	0	0.836
<u>Control variables</u>				
BD_SIZE	8.161	1.690	4	12
BD_MEET	5.304	2.221	0	16
FSIZE	570788719215.9232	5911735295831.11100	4070283	63951200000000
LEV	1.008	6.856	0	74.48
FAGE	26.31	13.712	1	63
Panel B: Dependent variable				
FIRM PERFORMANCE	.115	.393	.00	4.25

Table 2; panel A shows that there is a significant range of variation among the considered sample of this study. The range of family ownership *FAMILY_OWN* is from 0 to 0.95 with a mean of 0.095 and a standard deviation of 0.146. The range of domestic corporate ownership

DOMESTIC_OWN is from 0 to 0.836 with a mean of 0.068 and standard deviation of 0.156. With respect to the control variables, board size *BD_SIZE*, it ranges from 4 to 12 with a mean of 8.161 and standard deviation of 1.690. The range of board meetings *BD_MEET*, it ranges from 0 to

16 with a mean of 5.304 and a standard deviation 2.221. With respect to firm size *FSIZE*, it ranges from SR 4070283 to SR 63951200000000 with a mean of SR 570788719215.9232 and standard deviation of SR 5911735295831.11100. The range of firm leverage *LEV* is from 0 to 74.48 with a mean of 1.008 and standard deviation of 6.856. The range of firm age *FAGE* ranges from 1 to 63 years with a mean of 26.31 and a standard deviation of 13.712. Table 2; panel B

shows that the range of firm performance *FIRM_PERFORMANCE*, the dependent variable, ranges from .00 to 4.25 with a mean of .115 and standard deviation of .393.

The Pearson correlations between the variables are presented in Table 3. Most of the coefficients of correlation are small and the highest correlation was between *FSIZE* and *DOMESTIC_OWN*, indicating that larger firms are owned by domestic corporations.

Table 3 Pearson Correlation Analysis results (n = 117)

	FAMILY_OWN	DOEMSTIC_OWN	BD_SIZE	BD_MMET	FSIZE	LEV	FAGE
FAMILY_OWN	1						
DOMESTIC_OWN	-1.81	1					
BD_SIZE	.571	.076	1				
BD_MEET	.043	.237	-.177	1			
FSIZE	-.068	.436	.376	-.014	1		
LEV	-.057	-.042	-.119	.456	-.183	1	
FAGE	.135	-.016	.002	.085	-.160	-.050	1

** Significant at 1 per cent level (2-tailed).

*Significant at 5 per cent level (2-tailed).

The correlation matrix confirms that no multicollinearity exists between the variables as none of the variables correlates above 0.80 or 0.90 all variables have a correlation of less than 0.436 (Myers, 1990).

4.2 Regression results and discussions:

Ordinary-Least Square (OLS) was used to evaluate the level of effect of the hypothesized variables, family ownership, domestic corporate ownership and firm performance. Table 4

reports the estimated model coefficients, the associated significant test results, the adjusted R^2 and the F -values for the model. The F -value for model is statistically significant at the 1% level, indicating that the overall model can be interpreted. The adjusted R^2 is 0.963. The statistics show that this model has explained 96.3% of the total variance in the firm performance.

Table 4 Pooled OLS regression (n = 117)

Variables	Expected sign	Coeff.	t	p-value	Tolerance	VIF
(Constant)			2.013	0.47		
FAMILY_OWN	+	0.013	0.243	0.808	.939	1.065
DOMESTIC_OWN	+	0.115	2.106	0.038	.718	1.393
Control variables						
BD_SIZE		0.006	1.314	0.192	.819	1.221
BD_MEET		-0.008	-1.872	0.064	.662	1.510
FSIZE		-0.018	-1.847	0.068	.647	1.546
LEV		0.057	45.853	0.000	.707	1.415
FAGE		0.001	1.388	0.168	.908	1.101
Adjusted R^2		96.3				
Model F -stat.		410.987				
P -value		0.000				

As illustrated by Table 4, there is insignificant association between family ownership *FAMILY_OWN* and firm performance *FIRM_PERFORMANCE* ($\beta = .013$, $t = 0.243$, $P = .808$). This result is inconsistent with the prediction of agency theory and the empirical evidence provided by Chu (2011), Mishra et al. (2001), and Wiwattanakantang (2001). Thus, hypothesis 1 is not supported. As for the association between domestic corporate ownership *DOMESTIC_OWN* and firm performance *FIRM_PERFORMANCE*, the direction of this relationship is positive and significant at 5% ($\beta = .115$, $t = 2.106$, $P = .038$). This result indicates to the positive influence of the domestic corporations on firm value. This result is consistent with agency theory prediction and supporting studies (Chhibber and Majumdar (1999); Djankov and Hoekman (2000); Khanna and Palepu, 2000; Claessens et al., 2000; Dharwadkar, George & Brandes, 2000; Douma et al., 2006). Thus, we accept hypothesis 2.

5. Conclusions and implications

Our study examines the association of family ownership and domestic corporate ownership with firm performance in Saudi Arabia for the year 2013. The hypotheses of this study are based on the premise that family ownership and domestic corporate ownership are positively associated with firm performance. The result shows a support to the agency perspective in terms of the association of domestic corporate ownership and firm performance. Therefore, the results of this study can be used as a piece of evidence adding to the current body of literature about Saudi Arabia and similar markets. In addition, important implications of this finding relate to the issues of firm performance, and ownership structure. Saudi government, stock

market, companies and accounting and auditing regulators would gain some new insights from this study in terms of understanding the association of family ownership and domestic corporate ownership with firm performance. The results of this study would benefit banks in the way that they can assess the creditworthiness of incorporating companies in Saudi Arabia. Moreover, credit decisions made by lenders are determined based on information included in the financial statements. Therefore, firm performance issues are of the utmost important for any lending institution. Investors and financial analysts may depend on issues of the firm performance to interpret decisions related to bonds, bond rating, interest rate, and all other decisions related to investments in Saudi Arabia. Accordingly, increased understanding and prediction of companies' events is important to this user group. Further, the results of this study will be of interest to the researchers and academic community due to a lack of formal research body addressing the issues of firm performance and ownership structure and, therefore, this study will provide substantial information about issues in the market of Saudi Arabia to count on, in the future, as premise data. Limitations of the study lie on the other ownership classifications (i.e., government ownership and blockholders). Future line of research should exert effort to introduce these ownership classifications. Further research should replicate this model to determine its validity in different contexts of Arab countries especially GCC region, in different time periods, and with different sample size. These limitations may motivate more future research in the Middle East markets.

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تأثير هيكل الملكية في قيمة الشركات السعودية: دراسة تطبيقية

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المُلخَص

تستهدف هذه الدراسة اختبار علاقة هيكل الملكية (الملكية العائلية، وملكية الشركات المحلية) بأداء الشركات المدرجة في السوق المالي السعودي للعام 2013م. إذ تمثلت العينة النهائية لهذه الدراسة بعدد 117 شركة. أوضحت نتائج تحليل انحدار المربعات الصغرى الاعتيادي أنّ هناك علاقة طردية ذات دلالة إحصائية بين ملكية الشركات المحلية، وأداء الشركات المدرجة في السوق المالي السعودي، وأنّ نتائج هذه الدراسة لم تستطع إثبات تلك العلاقة فيما يتعلق بالملكية العائلية بحسب نموذج الدراسة المقترح. تعد نتائج هذه الدراسة مهمة لوضع السياسات على مستوى الدولة، وعلى مستوى الشركات فيما يتعلق بالقضايا المرتبطة بهيكل الملكية، وأداء الشركات. الجدير بالذكر، يمكن للدراسات المستقبلية الاستفادة من الدليل التطبيقي الذي تقدمه هذه الدراسة لفهم القضايا المتعلقة بهيكل الملكية، وأداء الشركات في بيئة أعمال المملكة العربية السعودية، وبقية الدول العربية الأخرى.

كلمات البحث الدالة: هيكل الملكية، وربحية الشركة، والسعودية.