



**An Assessment of the Impact of Corporate Governance Practices on
the Values of Firms in the United Kingdom and Kingdom of Saudi
Arabia: A Comparative Study Using the Ethical Process Thinking
Model (EPTM)**

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ABSTRACT

There are many scandals and collapses of companies around the world, and there has been a renewed interest in the impact of corporate governance on the firm value. According to the literature on corporate governance, the roles of regulatory authorities, company boards and management, vendors, customers, banks and other funding agencies including creditors are important in contributing to the firm value. This is true both in the case of both developing and developed countries. In the context of both developing and developed countries, the protection of shareholders depends mainly on adoption and following of good corporate governance practices. However, it needs to be appreciated that the impact of corporate governance practices in different countries might differ because of dissimilar corporate governance structures evolved from disparate social, economic and regulatory conditions existing in the respective countries. Thus, the differences in the social, economic and regulatory conditions prevailing in the developing and developed countries determine the nature and operational processes of corporate governance practices. Such differences in the corporate governance practices, in turn, have a serious impact on the firm value. The differences in the regulatory framework and market behaviour that exist in the developing and developed countries appear to influence the value and performance of the firm to a large extent. Therefore, the corporate governance practices in developed countries appear to be superior in quality and they are likely to have a beneficial influence in improving the firm value in the developed countries. Furthermore, the introduction of corporate governance standards by the Organisation for Economic Cooperation and Developments (OECD) in 1999 had given a head-start for the developed economies to frame appropriate governance structures over the period. This

has helped the developed countries to have effective corporate governance practices in place to aid the improvement in firm value.

On the other hand, in the case of developing countries, lack of development of a well-structured regulatory framework and the differences in other social and economic conditions tend to affect the quality of the corporate governance practices. These factors also affect the effective implementation of good corporate governance practices. As a result, the corporate governance practices may not have the desired positive influence on the firm value in the case of developing countries. For example, in such countries, where state ownership companies are predominant, quality of the government officials managing the state-owned corporations determine the corporate behaviour and the resultant impact on the firm value. Similarly, the development of healthy financial markets as affected by the legal foundations and enforcement also could influence the level and quality of corporate government practices in the developing economies. Ownership structure is another important factor that has its own impact on the effectiveness of corporate governance practices in the developing countries. Therefore, it becomes important for the developing countries to consider these differences in the analysis of the prevailing corporate governance practices and their impact on firm value, in order to have a thorough understanding of the role of corporate governance and their influence in enhancing firm value. However, it seems the existing literature is lacking in systematically discussing these differences.

A great deal of research has been done in developed countries such USA and UK; however; there is relatively little evidence in the Middle East in this area especially in Saudi Arabia. This study investigates corporate governance practices and their impact on firm value in the United Kingdom and the Kingdom of Saudi Arabia. Quantitative data was analysed by SmartPLS software version 3.0. Operationalising a theoretical model described as the Ethical Process Thinking Model (EPTM)), a comparison was made between the listed companies in these two countries.

This study is based on the two sets of data: (1) a sample of 342 firms listed in the listed on the London Stock Exchange and Saudi Stock Exchange (Tadawul); (2) Data was collected from the annual reports of listed companies over five years (2010 – 2015).

Different pathways enumerated in the TM displayed significant impact and implications on corporate governance leading to firm value. This study used three pathways out of six possible pathways, which are (i) Rule-based pathway ($P \rightarrow J \rightarrow D$) (ii) Principle-based pathway, ($I \rightarrow J \rightarrow D$) and (iii) preference-based pathway ($P \rightarrow D$). The results indicated that the ($P \rightarrow J \rightarrow D$) pathway found that there is significant relationship between board characters and audit committee and on the financial health and firm value, while the ($I \rightarrow J \rightarrow D$) pathway indicated that there is significant relationship between profitability and liquidity on the financial health and firm value. Finally, the ($P \rightarrow D$) pathway displayed that there is a direct impact of board characters and audit committee on firm value.

DEDICATION

This thesis is dedicated to my father Attlah, my mother Aqeelah and my beloved family

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LIST OF ABBREVIATIONS

AIA	Associated of International Accountants
ACCA	Association of Chartered Certified Accountants
AC	Audit Committee
AVE	Average Variance Extracted
CMA	Capital Market Authority
CIMA	Chartered Institute of Management Accountants
CIPFA	Chartered Institute of Public Finance and Accountancy
CR	Composite Reliability
CA	Cronbach Alpha
DBEIS	Department for Business, Energy and Industrial Strategy
EPTM	Ethical Process Thinking Model
EU	European Union
EFA	Exploratory Factor Analysis
FDI	Foreign Direct Investment
GDP	Gross Domestic Product
GCC	Gulf Co-operation Council
ICAEW	Institute of Chartered Accountants in England and Wales
IFC	International Financial Corporation
IMF	International Monetary Fund
KSA	Kingdom of Saudi Arabia
LSA	London Stock Exchange
OECD	Organisation for Economic Co-operation and Development
OPEC	Organization of Petroleum Exporting Countries
PLS	Partial Least Squares
PBUH	Peace Be Upon Him
PCG	Principles of Corporate Governance
ROA	Return on Assets
ROE	Return on Equity
SCGC	Saudi Corporate Governance Code
SOCPA	Saudi Organisation for Certified Public Accountants

SSE	Saudi Stock Exchange
SPSS	Statistical Package for the Social Sciences
SEM	Structural Equation Modelling
UK	United Kingdom
VIF	Variance Inflation Facto

Chapter 1

INTRODUCTION

1.1 BACKGROUND AND OVERVIEW

In light of the many corporate financial scandals seen in recent years, corporate governance has become a central focus within many developing economies. Several internationally renowned firms, such as Enron, WorldCom, Polly Peck, Royal Ahold and Parmalat Maxwell, have been subject to financial irregularities that have generated substantial financial losses for various of their stakeholders, including creditors, investors, employees and governments. Shared features of these financial failures have been identified, and weaker internal control arising from poor corporate governance practices has been found in these organisations (Darus and Mohamed, 2011).

The discovery of such financial irregularities in large corporations have fuelled the demand, from corporations, regulatory bodies, governments and other stakeholders for effective corporate governance practices and implementation (Baydoun et al. 2013). The scandals have also revealed inadequacies in scrutiny carried out by the auditors of the financial records of these corporations, and the consequent reduced trust in the reliability of such financial records forms part of corporate governance weakness. Thus, financial irregularities have also cast doubt on the abilities of regulators and administrators, such as stock exchange authorities, policymakers and professional accounting and auditing bodies, to monitor and report on corporate behaviour. Therefore, according to Mangunyi (2011), the prevalence of well-publicised corporate failures has sparked a heated discussion about the need for effective corporate governance, primarily as a way to enhance firms' performance and consequent firm value, and to ensure that investors are adequately protected.

A recent spate of financial scandals was swiftly followed by the financial crisis of 2008¹ which affected the global economy profoundly. As stated by Jen (2014), the merger of corporate financial scandals with financial crisis resulted in new regulations and rules being implemented for regulating corporate practices and governance in countries that are developed as well as those developing. As has been noted by Lopatta and Kaspereit (2014) and Pandya (2011), corporate governance regulations have been revised and strengthened in numerous countries, in light of the recent economic downturn and particularly with respect to corporate governance disclosures and degrees of transparency.

For example, the Sarbanes-Oxley Act of 2002², enacted in the United States, introduced regulations to cover matters of board, audit independence and corporate disclosures as part of that country's improved corporate governance mechanisms (Ali, 2014). More generally, the need for viable and robust corporate governance practice has been promoted in both developed and developing economies, as a consequence of financial scandals and global economic fragility.

The perceived role and contribution of corporate governance to a firm's value has made the concept of corporate governance a continuous focus of academic research.

Corporate governance is a multi-faceted concept, and so has generated a range of understandings and interpretations. A key effect of this has been the lack of a concise and acceptable definition of the term. The various explanations offered by practitioners and academics have associated the concept with a wide range of corporate issues, although most explanations foreground the agency relationship that exists between directors and shareholders, and the links between corporate governance and governance of the corporation.

¹ Here, we are referring to the financial crisis which erupted in the period from 2007 to 2008, commonly referred to as the global financial crisis'. Numerous economists regard that global financial crisis as having been the most severe in history.

² The US Congress passed the Sarbanes-Oxley Act (SOX, 2002) with the aim of safeguarding shareholders and the public from accounting errors and instances of corporate fraud. At the same time, SOX sought to heighten the quality and accuracy of corporate disclosures.

As a case in point, the definition of corporate governance given by Roberts et al. (2005) suggests that corporate governance can be conceptualised as a system, the fundamental purpose of which relates to the direction and control of companies so as to bring about effective business practices. On the other hand, Sheleifer and Vishny (1997) define it as a set of mechanisms that have the objective of protecting the interests of the shareholders. From these definitions, it can be deduced that corporate governance is primarily intended to ensure the running of companies in such a way that shareholder value is maximised. In effect, therefore, corporate governance can be considered as a bridge that connects the shareholders of a company with those who are responsible for managing the affairs of that company. This notion is consistent with the work of Pass (2006), who suggests that corporate governance can be viewed as a system which establishes the rules and regulations that inform the roles played by a firm's board of directors, specifically regarding the implementation of business operations and the maintenance of shareholder relationships.

When scholars discuss the effectiveness of corporate governance, they usually refer to a general idea concerning the degree to which the foundational tenets of corporate governance are being applied so as to bring about stakeholder benefits, industry-related benefits and sector-related benefits. The benefits that can be expected from the implementation of effective corporate governance practices include the resolution of conflicts of interest among the stakeholders, assurance of monitoring, control and a sense of ethical practice and appropriate transparency. Corporate governance also provides another advantage in the form of efficiently utilising resources in individual firms as well as in the economy overall. Gregory and Simms (1999) have observed a close relationship between the effectiveness of a firm's corporate governance practices and the degree to which creditors and investors are confident in the firm, and they conclude that this promotes the firm's cheaper acquisition of capital, at both the domestic and international levels. In short, effective corporate governance systems and practices help companies to benefit from deep and transparent financial markets and robust legal systems, which in turn contribute to the stability of economic growth. Efficient resource allocation also helps the firm to enhance its performance and value for the shareholders (Banks, 2004).

In general, corporate governance is defined by OECD as “the system by which business corporations are directed and controlled. The corporate governance structure specifies the distribution of rights and responsibilities among different participants in the corporation, such as, the board, managers, shareholders and other stakeholders, and spells out the rules and procedures for making decisions on corporate affairs. By doing this, it also provides the structure through which the company objectives are set and the means of attaining those objectives and monitoring performance” (OECD, 1999).

For the purpose of this study, corporate governance is defined as the set of processes, policies, customs and institutions that influence the way in which a corporation is directed and controlled. The term corporate governance also encompasses nurturing and administering the relationship among all the key stakeholders including the board of directors and the shareholders involved in achieving the organisational objectives of the corporation. Effective corporate governance can be expected to curb the opportunistic behaviours among managers and reduce the asymmetry of information so that the quality of disclosed information is maintained. For the purpose of this study, the study of corporate governance will focus on the impact of the related practices on the firm value and financial health of the firms. In assessing the impact of corporate governance on these two variables (firm value and financial health), this study reviews the broader concept of corporate governance through the prisms of board characteristics and effectiveness as well as audit committees and their effectiveness in improving the financial health and firm value. In the process, this study tries to elucidate the role of audit committees as a monitoring mechanism under corporate governance for improving the quality of information flow between the management and the shareholders which will greatly enhance the firm value.

Since the start of the twenty-first century, the critical nature of corporate governance has been more widely appreciated by businesspeople than ever before, at least in developed states in the West, and this can be viewed as having been promoted by the revelation of fraudulent corporate activities (Baker and Anderson, 2010). While it may have been catalysed by these corporate frauds, the promotion of corporate governance has also been supported by the social and economic cultures of developed countries. The Western countries appear to provide an atmosphere that is conducive to the implementation of effective corporate governance and disclosure practices, due to the presence of established financial markets and legal systems, and awareness of the need

for corporate governance. It is important to recognise that the presence of less concentrated ownership structures and, furthermore, established stock exchanges in the developed world have created a context whereby the principles of corporate governance are more readily adopted. Regulatory and professional bodies have also helped to develop and embed corporate governance norms and practices, which has led to the development of effective corporate governance practices and codes of best practice in these countries.

Furthermore, in developed countries, recognition of the critical nature of effective corporate governance has sparked a series of reactionary structural changes and reforms, including the UK's Combined Code and the US's Sarbanes-Oxley legislation. However, the codes of best practice that have been developed to meet the requirements of developed countries have been found less useful in the context of developing countries, due to various social and economic factors affecting the corporate behaviour in those developing nations.

Almost all of the scholarly literature pertaining to corporate governance seems to focus on the mature market situations that characterise developed countries, which is understandable in view of the numerous natures of corporate governance systems in the West. Nevertheless, there remains a critical question that cannot be overlooked, and this relates to the degree to which the corporate governance difficulties found within developing countries are comparable to those observed within their developed counterparts.

Furthermore, it is important to examine the degree to which developing countries have the capabilities required to address the governance problems that frequently emerge in the developed world. The efficacy of corporate governance systems in developed and developing countries may differ, owing to the impact of dissimilar regulatory and economic conditions, and these may lead to the establishment of different corporate governance structures and practices. In a similar way, the benefits that may be derived from corporate governance practices may vary, depending on the characteristics of a given country or countries, as well as the corporations that exist there.

At the end of the 1980s and the beginning of the 1990s, as a consequence of the corporate scandals arising from the proliferation of fraudulent and negligent practices among managers, corporate governance practices were increasingly identified as a critical matter in developed countries, particularly in the United Kingdom (UK). The resultant establishment of the Cadbury Committee on the Financial Aspects of Corporate Governance was one response to this environment.

The underlying purpose of the Cadbury Committee was to assess the degree to which audits were effective, and according to Rayton and Cheng (2004), to gain insight into the structures and obligations of boards of directors. In addition to this, the Cadbury Committee recommended that a review take place, regarding the implementation of, and compliance with, the many suggestions it proposed regarding the composition and conduct of important board committees, the position of non-executive directors, and the matter of transparent financial information disclosures and financial reporting. Following the publication of the Cadbury Committee's report, in 1992, a series of follow-up initiatives, each addressing certain aspects of the corporate governance sphere in the UK, emerged. These were the Hampel Report, the Higgs Committee, the Turnbull Committee and the Turnbull Review Group. The ultimate outcome of the proposals made in the course of the Turnbull Review Group was the publication of the Combined Code of Corporate Governance, in 1999. Furthermore, on the basis of the suggestions provided by the Turnbull Review Group, novel concepts were developed in the sphere of corporate governance, including those relating to matters of risk management, internal audit, and internal control, the fundamental intention being to promote the efficacy of corporate governance in the UK firms. A more thorough treatment of the UK's corporate governance system and its effectiveness is given in Chapter 4.

The establishment of corporate governance systems in developing states and nations is an increasingly hot topic in the scholarly literature, and it is also discussed among policymakers. For the most part, the attention this aspect of the subject has received relates to the evolution of a national code of corporate governance for each developing country, and academics are also paying greater attention to the degree to which each developing country is capable of complying with international corporate governance principles and practices. It is particularly important to note, however, that the available literature addressing corporate governance issues in the developing world suggests that

a misalignment exists, between developing countries' established corporate governance mechanisms and the degree to which these are conformed to in a robust manner. Furthermore, evidence indicates that developing countries may either fail to implement effective corporate governance practices, or implement them in an unsatisfactory way. Ultimately, the picture painted in the literature is one of a situation whereby the firms in developing countries fail to conform to the central tenets of corporate governance codes and, furthermore, one where corporate governance itself, as a concept and as a practical reality, is only in an embryonic phase. As summarised in the research conducted by Black et al. (2010), the empirical literature conducted on corporate governance in developing countries indicates that severe limitations exist with respect to current corporate governance frameworks, and that there is thus a need to promote greater efficacy in these countries' corporate governance measures.

In many developing countries, there are fundamental limitations upon the extent to which effective corporate governance measures can be robustly implemented. These include a lack of regulation by professional agencies, little or no awareness of the criticality of corporate governance, weak regulation, a lack of independent members on boards of directors, minimal levels of corporate disclosure, negligible transparency and non-adherence to corporate governance standards. It is important to state that addressing these limitations is expected to promote firm value and, consequently, to elevate the level of economic development across the developing world (Banks, 2004; Crowther and Lez-Rayman-Bacchus, 2004). This becomes important in view of the fact that correct corporate governance generates a complex structure involving laws, regulations, politics, professional bodies and codes of ethics and behaviour.

Nevertheless, it is important to recognise that corporate governance systems in the developing world, which are sufficient in all of the above regards, are few and far between. Chowdary (2003) has noted some of the key hindrances that undermine the establishment of effective corporate government systems in the developing world, and these include the following: firstly, a lack of independence among the judiciary (and, indeed, the legal system as a whole); secondly, the lack of developed institutional structures; thirdly, insufficient human capital; fourthly, the inherent complexities associated with the development of a viable corporate governance system and finally, the undefined relationship that exists between governments and the financial sector, in particular the lack of formal structure and description of that relationship.

Weakness in corporate governance system has been identified by some as a key contributing factor to the economic crisis in Asia in 1998, which forced the region's governments to implement effective corporate governance structures in developing states. It was anticipated that governance reforms in those developing countries would provide for the development of secured institutional structures (Monks and Minnow, 2004). However, although the concept of corporate governance has been introduced into developing countries through the establishment of different codes, the implementation of such beneficial practices has not been effective.

One way in which to account for the ineffective nature of corporate governance implementation stems from the fact that systems originally formulated for use in developed countries are not always relevant to, or suitable for use in, their developing counterparts. This may be the case for several reasons; it may be due to different economic conditions, disparate national characteristics and non-uniform or incomparable social structures. It is also worth noting that corporate governance in the developing world is affected by some specific and predominant ownership structures.

For the most part, developing countries rely on foreign direct investment (FDI) as a primary means by which to catalyse their economic development. The investment potential in these countries is thus evaluated by international investors, who assess the relevant legal and accounting systems, calculate the extent of fraud risk and gauge the effectiveness of corporate governance. Therefore, in order to build investor confidence, it is important that the developing countries undertake corporate governance reforms, including transparency in financial reporting and disclosures (Abhayawansa and Johnson, 2007).

In the Kingdom of Saudi Arabia (KSA), the significant political, social, and economic reforms initiated by the government in order to further the country's economic progress have highlighted, to a greater extent than ever, the importance of bringing about radical change in the functioning of the corporate sector. As a consequence of both the Asian financial crisis of 1998³ and the global financial crisis of 2008, the sense of urgency with which viable corporate governance and disclosure practices, and especially

³ The Asian financial crisis of 1998, which began in July 1997, sent shockwaves throughout the international community, despite its localisation to the region of East Asia.

practices which conform to international benchmarks, should be established in the KSA has been heightened (Hussainey and Al-Najjar, 2012).

It is helpful to remember that the need for more effective corporate governance standards in the KSA has only emerged since the turn of the new millennium (Al-Motairy, 2003). The emergence of the Capital Market Authority, along with an increased number of companies being listed on the Saudi Stock Exchange (SSE), prompted the KSA to increase the stringency of its corporate governance practices. At the same time, international agencies, such as the World Bank and the International Monetary Fund (IMF), encouraged the KSA to establish a more rigorous environment for corporate governance (Clarke, 2004). As a consequence, 2006 saw the establishment of the Saudi Corporate Governance Code (SCGC), the fundamental purpose of which was to increase the level of voluntary adherence to corporate governance requirements (Al-Moataz and Hussainey, 2012; Soliman, 2013).

Yet, despite the importance placed upon the implementation of better corporate governance practices in the KSA, there are many factors, including ownership structures, which impede the effectiveness of such practices. More information about the need for implementing effective corporate governance and disclosure practices in a developing country like KSA is given in Chapter 4.

Therefore, evaluating how the value of firms in the KSA is affected by enhanced corporate governance practice, perhaps by comparing it with the value of firms being impacted in the UK, is vital.

This study presents such research, which has been conducted using the ethical process thinking model (EPTM) to assess the relationship between corporate governance practices and a firm's value, undertaking a comparative study and comparison with the corporate governance principles of the UK. The EPTM has been selected because due to its unique nature, of using six dominant decision pathways that are related to six significant ethical positions (Rodgers, 1997). This model is considered most appropriate for this research because corporate governance is, after all, based on ethical ways of doing business while taking care of the interests of all stakeholders, including the shareholders.

Use of the EPTM promotes analysis of the potential effects of corporate governance practices on firms' values, by taking into account the decisions and choices of various parties connected with the conduct of those firms' business. This model is based on the premise that various concepts, namely perceptions, information, judgment and decision can be combined and implemented in a specific sequence before one can make a choice. The model also assumes that it is not necessary to involve all four major concepts whilst engaging the six pathways. In the EPTM, the concepts of perception and information are interdependent because the ability of the decision-maker to perceive a problem is influenced by the information in the possession of the decision-maker, or the way in which the information is chosen for the purpose of decision-making. In a typical situation in which a corporate governance practices is implemented, the decision-making processes, and the factors affecting the decisions, become important. Therefore, studying the basic concepts of perception, information, and judgment in the decision-making process of corporate governance using a EPTM conveys a substantial benefit to the research. The EPTM will be discussed in greater detail in Chapter 2.

1.2 MOTIVATION FOR THE STUDY

According to Kiel and Nicholson (2003), the very concept of corporate governance, as well as the degree to which it has an effect on firms' values, has been hotly debated in recent decades. Furthermore, a number of recent, notable, corporate failures have highlighted the need for new and further research into the links between corporate governance practices and company valuations. In particular, since the extant literature focuses primarily on the West, demand is now increasing for information and guidance on the implementation and standards of corporate governance for international application. As has been noted by Aguilera and Cuervo-Cazurra (2009), international agencies such as the Organisation for Economic Co-operation and Development (OECD) have formulated corporate governance guidelines, the main purpose being to establish a framework for effective corporate governance that is suitable for global application. However, it is suggested by the OECD that the content and structure of that corporate governance framework must meet the unique requirements of each country, taking into account changes in economic and business circumstances (OECD, 2004). In the developing countries, in order to increase managerial capabilities and help the firms that have poor corporate governance structures to attract foreign direct investments, it has become important to provide efficient and effective corporate governance practices

(Marn and Romuald, 2012). Nevertheless, as highlighted by Chen et al., (2011), regardless of how or whether developing companies apply effective corporate governance codes in line with the recommendations of the OECD, many of their national characteristics (which may include any or a combination of partial legal systems, ineffective investor protection laws and the absence of a free market), differ sharply from the situation in more developed states and this will frequently have a negative impact on corporate governance. This situation exists in the KSA; thus, it is useful to examine the degree to which corporate governance practices are appropriate, implemented and effective in the KSA (Tsamenyi et al., 2007).

It is also important to recognise that, typically, developing countries lack aspects of the infrastructure required to assure some corporate governance issues, including mature financial institutions and developed financial systems. Furthermore, according to O'Regan et al., (2005), a substantial body of evidence indicates that when corporate governance structures are not optimally effective, firms are more likely to perform poorly when compared against their counterparts, i.e. other firms that have a good corporate governance structure, and shareholder value is typically lower. In light of this, for the purpose of enhancing firms' values, it is necessary for developing countries to establish more effective corporate governance practices (Mulili and Wong, 2011). This is because, as has been widely documented, viable corporate governance practices are valuable in helping developing countries to limit their markets' vulnerability to financial crises, and to heighten firms' values (Al-Matari et al., 2012). The implementation of effective corporate governance practices also gives companies better access to external funding, due to the resulting increase in their value (Black et al., 2006).

The ability of the KSA to benefit from effective corporate governance practices depends largely on how quickly the country is able to strengthen its capital market, and to establish effective corporate governance standards throughout the market. The country can do this by drawing on the experiences of developed countries in terms of putting effective corporate governance practices into place. This context provides the necessary motivation for this research, as it becomes clear that comparing the corporate governance practices in the KSA with those of the UK will provide deep insight and understanding that will be of great theoretical and practical value in terms of improving the effectiveness of corporate governance practices in the KSA.

Saidi (2004) stated that though the problems concerning corporate governance in Middle Eastern countries have been widely examined, there is lack of sufficient studies regarding OECD's suggested established principles. In addition, it has been shown that the corporate governance practices in these countries, including KSA, are less well established than is the case in Western countries (Schieffer et al., 2008). However, the need for companies in the region to implement effective corporate governance has been highlighted recently, and particularly during the global financial crisis of 2008. That financial crisis led to significant increases in the perceived importance of, and focus upon, the development and application of sound corporate governance principles, as these were generally found to solve many problems relating to the market environment in these countries (which include Greece, Japan and Russia). The widespread public debates have fuelled recognition of the need to develop an effective system of corporate governance, to enhance economic function and financial transparency in the Middle Eastern region (Leigh, 2011). This is particularly true in KSA, where the intention of the government to steer the economy away from dependence on oil has accentuated the need to develop and expand the private sector, a shift that has brought with it a specific focus on improving corporate performance in the country. This change has foregrounded the need to understand, develop and improve corporate governance standards. In this context, the research presented in this study, which includes a comparison of corporate governance practices in the KSA and the UK, becomes particularly significant and relevant.

The issue of applying corporate governance in developing countries has been examined by numerous researchers, and most of the literature concludes that corporate governance practices in such countries are, typically, poor. Additionally, almost all researchers recommend that firms' values would increase if more effective corporate governance practices were to be adopted in such countries. However, it should be noted that relatively few studies have been conducted in the KSA, or in other countries of the Arabian Peninsula. Hence, one purpose of the present study is to account for this gap in the literature, and this will be achieved by comparatively examining the corporate governance practices of the KSA in relation to those of the UK which are a developing and a developed country, respectively.

In 2006, the Saudi Stock Exchange (SSE) sustained a serious blow, in the form of a stock market crash frequently referred to as 'the great collapse'. There has not been any major setback to the Saudi Capital Market until 2006. The Saudi Capital market experienced a sudden spurt in the volumes that were traded from 2003. Growth of the domestic economy, increased confidence in the capital market, spectacular earnings of many companies, reduction in the rate of deposits and increase in the new investors into the market can be cited as the reason for such sudden expansion in the Saudi Capital market. While the Tadawul All Share Index (TASI) closed at 16712 points in 2005, registering an increase of 103% over 2004, the Index was at its peak at 20,634 points on February 25, 2006. At one point of time, more than 50% of Saudi Nationals were trading in Saudi Stock Exchange. However, at the end of February 2006, the Index started falling down losing 52.33% as at the end of 2006. The market capitalisation stood at US \$ 326.9 billion at the end of 2006, which accounted for a reduction of 49.72% from 2005. The impact of the great crash on several Saudi citizens and families was so severe that many of them have lost their entire life savings. The country has lost almost SAR 2 trillion equivalent to US \$ 533 billion in its overall wealth.

There were many reasons attributed to the great collapse. These include unrealistic expectations of profits, artificial monitoring of stock prices by few wealthy Saudi nationals who bought and sold shares among themselves, inside information and the non-existence of the rumoured profits. The investment decisions were taken by the investors without considering the performance of the companies, overall macro and micro economic conditions and other essentially related factors. The investments decisions were mainly based on the advice from family and friends and public announcements by stock brokers. The banks provided overextended credit to borrowers for investments in the stock market, instead of educating the investors with sound financial advice. There was a complete absence of transparency and fairness in the market. One of the factors that led to the great collapse was the lack of transparency and disclosures by the listed companies, banks and many of the government agencies that were having strong connections with the stock market. There were no disclosures of financial statements by many listed companies. Investors could not understand the fact that the prices of shares of listed companies had increased beyond reasonable level without any relationship to the financial performance of the respective companies. In fact, some of the companies were using their capital reserve in order to disguise their

operating losses. Since the Capital Market Authority being young formed only in 2004, did not intervene to prevent the abusive practices of companies with the fear that any action might lead to negative consequences. Irrespective of the reasons, the inaction on the part of the CMA encouraged the violators to continue to indulge in illegal behaviour destroying the market growth and confidence. Thus, the great collapse opened the gateway for stringent reforms in financial reporting by listed companies and imposing of several other conditions which led to serious reforms in the corporate governance requirements in the country.

A natural consequence of this was for stakeholders to inquire as to whether the various monitoring devices in place within the KSA were sufficient to safeguard shareholders' interests. Although the KSA's Capital Market Authority has published regulatory guidelines since the 2006 SSE crash, the need still remains, to evaluate the degree to which companies are currently complying with the regulations the specify corporate governance requirements. Ultimately, the study presented here is expected to yield valuable insights into the corporate governance issues that must be enhanced in the KSA, with a view to enhancing corporate valuations among the country's leading companies. This expectation has been formed from reports often found in the literature, which attest to the positive correlation between effective corporate governance practices and firms' values (Bauer et al., 2008; Brown and Caylor, 2004; Farag et al., 2014; Al-Najjar, 2014). Moreover, this study uses the distinctive EPTM to achieve its objectives.

1.3 RESEARCH OBJECTIVES

The primary aim of the present study is to comparatively examine the corporate governance practices now applied in the KSA and the UK, and to use the EPTM to determine the effect these practices have on firms' values. Generally speaking, the focal points of the study include the theoretical and practical aspects of corporate governance practices in the KSA and the UK, but in more specific terms, the research seeks to illuminate the way in which corporate governance practices have an impact on firms' values. Ultimately, it is expected that the findings will highlight potential areas in which the KSA's corporate governance practices can be improved, thereby promoting enhanced valuations for Saudi firms. The use of the EPTM to compare the KSA's corporate governance practices with that of a developed country is a novel approach,

which is being adopted in this type of academic research. In the process of achieving the central aim, this study proposes to achieve other objectives, which are given in the list below.

1. To design a model with the capability to comparatively examine the corporate governance practices, financial health and valuations of listed companies in the UK and the KSA.

2. To create empirical tests and apply these to the conceptual models, thereby examining the following correlations:

a. Board characteristics and firm value;

b. The audit committee and firm value;

c. Board characteristics and financial health;

d. The audit committee and financial health;

e. Board characteristics, the audit committee, and firm value (through financial health);

f. Profitability and financial health;

g. Liquidity and financial health;

h. Leverage and financial health;

i: To examine the associations between profitability, liquidity, leverage and firm value through financial health.

j: To compare the results in the KSA with those of the UK, and to explore these with reference to other studies conducted, and theories formulated, in this field.

1.4 RESEARCH QUESTIONS

This research questions fall into three groups, details of which follow.

1.4.1 Board Characteristics

The research explores four different board characteristics that are likely to impact a firm's financial health and value. These characteristics are board size, frequency of meetings, executive directors and non-executive directors.

The last decade has seen an increased likelihood of severe corporate failure, and this in turn has generated considerable enthusiasm for monitoring mechanisms. Effective corporate monitoring is often held to be achievable if independent directors are included on the company's board. In a similar way, a firm's level of disclosure is often regarded as being linked to board size. Based on the tenets of agency theory, board size is a fundamental consideration that has an impact on the process by which managerial behaviour can be supervised. For some researchers, the evidence indicates that larger board sizes are correlated with more effective managerial supervision, which stems directly from the fact that larger board sizes tend to heighten the quality of information disclosure (Ntim and Soobaroyen, 2013). Furthermore, as noted by Haniffa and Cooke (2002), firm value is likely to be increased by the presence of a greater number of directors, since this makes it is possible for the firm to capitalise on a more varied body of experience.

The effectiveness of board performance has been found to be significantly facilitated by the increased frequency of board meetings (Conger and Lawler, 2009). Directors can obtain firm-specific information through regularly attendance at board meetings, and thereby fulfil their monitoring role effectively (Adam and Ferreira, 2009). The role of executives as directors has been promoted on the grounds that such directors have a comprehensive understanding of the business of the company, and hence are well placed to make the most advantageous decisions concerning that business (Nicholson and Kiel, 2007). One of the key stipulations of agency theory is that as the number of non-executive directors on the board increases, the self-interested behaviour of managers can be limited considerably (Allegrini and Greco, 2013). In other words, when boards contain more non-executive directors, shareholder protection will increase, and this is likely to reduce agency-related costs. As has been emphasised by

La Porta et al., (2002), the more diverse the board, the lower the degree of information asymmetry.

In light of these matters, the following research questions have been formulated:

Q1: What impact do board characteristics, including size, meeting frequency, the number of executive and non-executive members, have on the financial health of listed companies in the UK and the KSA?

Q2: What is the impact of board characteristics, such as size, meeting frequency, executive and non-executive membership, on the firm value (through financial health) of companies in the UK and the KSA?

1.4.2 Audit Committee

This research explores two different aspects of the audit committee that are likely to have some impact upon the firm's financial health and value. These factors include meeting frequency and size. Financial reporting's effectiveness, as stated by Carcello and Neal (2003), can be improved by audit committee. Moreover, Raghunandan and Rama (2007) noted that there is a directly proportional relationship between an audit committee's size and its number of meetings. A greater number of meetings provides, it is argued, enhanced audit committee effectiveness and allows the committee to better carry out its monitoring responsibilities.

Nevertheless, the possibility should also be considered, that larger audit committees may be more susceptible to poor governance practices, as a direct result of their larger number of audit committee meetings (Vefas, 1999). Ultimately, however, audit committee size is anticipated to be positively related to effective corporate governance, and therefore to facilitate greater firm value. In view of this, the following research questions have been formulated:

Q3: What is the impact of audit committee characteristics, in particular the committee's size and frequency of meeting, on the financial health of companies in the UK and the KSA?

Q4: What is the impact of audit committees, and specifically their size and frequency of meeting, on the firm value (through financial health) of companies in the UK and the KSA?

1.4.3 Firm Characteristics

The research considers characteristics that are likely to have an impact on a firm's value, through its financial health. These factors include profitability, liquidity, leverage and financial health.

Profitability is positively associated with the extent of corporate disclosure. On the basis of signalling⁴ theory, it is possible to conclude that managerial personnel within high-performing companies more frequently than not over-report their earnings information, thereby promoting shareholder exuberance and, subsequently, serving their own interests by way of elevated compensation (Marston and Polei, 2004). Several studies that consider signalling theory have attempted to examine the relationship between firm liquidity and corporate governance disclosures, including Abd El Salam (1999). It is notable that El Salam's research finds that that in the event that a firm's liquidity ratio is elevated, it is likely to disclose a considerable amount of information to its stakeholders. Xiao et al., (2004) drew on agency theory and report that elevated levels of disclosure can increase the lenders' tendency to claim against amounts paid to shareholders, from reserves of spare cash available within the firm. In addition, the literature indicates that agency costs increase when the debt equity ratio is high (Debreceeny et al., 2002). The purpose of financial reporting, as an element of corporate governance disclosures, is to provide information regarding the financial performance and status of a firm, so that that its stakeholders can take meaningful business and investment decisions. It is important to bear in mind that such information need not, necessarily, relate only to accounting data. The disclosure must also provide comprehensive information about the financial health of the firm, which may be revealed by financial ratios and other relationships based on the firm's past performance.

⁴ In signalling theory, as stated by Connelly et al. (2011, p.40), the asymmetry of information between two parties is reduced, for which signals from the party that has the underlying quality are used to establish the quality.

Liquidity, in general, refers to the ability to convert an asset into cash with speed and certainty. Liquidity of a firm indicates the level of investment by a firm in different forms of current assets and liabilities which could be liquidated within a short period so that the day to day operations of the firm can be undertaken smoothly. Liquidity has a close relationship with the working capital of a firm. Liquidity, as measured by the effectiveness of working capital, can affect the performance of the firm by affecting its profitability. The business success of a firm therefore depends largely on the ability of the firm to effectively manage its liquidity level. It is for the firm to devise aggressive or conservative liquidity policies to achieve its financial objectives. The liquidity of a firm can be measured by employing different financial ratios, the most important of which is the current ratio and the quick ratio. These ratios represent the level of current assets over the current liabilities and the ability of a firm to meet its current liabilities by deploying the current assets at its disposal. The higher the liquidity, the higher is the better financial position of a firm.

While the performance of a corporation in terms of its growth in sales and geographical diversion is of paramount importance, it is also equally important that the financial health of the corporation is sound. Then only the corporation can ensure sustainability. The financial health of a company can be represented by its profitability. Suitable financial ratios can be deployed to assess the financial stability of a business entity. Ratios like sales to assets can indicate the soundness of the financial health of a company. A company can be said to have financial health, when its short term and long term financial soundness is maintained. The liquidity as revealed by the current and quick ratios, the financial leverage as indicated by the debt to equity ratios and the profitability of the company as disclosed by profit to assets or profits to sales are the important parameters on which the financial health of a company can be ascertained. The consistency in the dividend paying capabilities can also indicate the degree of financial health of a company. It becomes the responsibility of the board as well as the audit committee to ensure that the resources of the company are deployed efficiently to ensure adequate profitability, which in turn will ensure the sound financial health of the company. Tallman and Li (1996) stated that profit to assets or profit to sales ratios can represent a firm's financial health. The present study, however, uses the Z -1 * Zmijewski score (Zmijewski, 1984) as the financial health score's proxy for discerning

the financial health of those sample companies that are included on the stock exchange. This, in turn, results in this study's final questions that are to be examined:

Q5: What is the impact of profitability, liquidity and leverage on financial health of listed companies in the UK and the KSA?

Q6: What is the impact of profitability, liquidity and leverage on firm value (through financial health) of listed companies in the UK and the KSA?

A more detailed review and discussion of these questions with hypotheses will be given in Chapter 3.

1.5 RESEARCH METHODOLOGY AND METHODS

The study presented here will investigate the impact of corporate governance practices on the value of the firm, through comparison of the relevant situations in the UK and the KSA. There will be a particular focus upon the impact of board characteristics, the audit committee and characteristics of the firm upon the value of the firm (Bhagat & Bolton 2008).

The study uses quantitative methodology, primarily the statistical analysis of factors that influence the value of the firm. This is a positive paradigm measure. In applying such a quantitative approach, the hypothesis/hypotheses is/are developed in light of relevant theories, and then tested using regression analysis (Frag, et al., 2014). The regression analysis examines 1) board characteristics that impact the value of a firm, 2) aspects of the audit committee that impact firm value, and 3) other characteristics of the firm that impact firm value.

1.5.1 Data Collection

The data sample used for quantitative analysis in this study is derived from 156 UK (London Stock Exchange, LSE) and 180 KSA (Saudi Stock Exchange, SSE (Tadawul)) listed companies, targeted on the basis of market capitalisation. The sample size stems from the need to compromise between the limitations of manual data collection, and the need to fulfil the requirements of parametric testing. Corporate annual reports from 2010-2015 are used to analyse financial and non-financial information at each company.

1.5.2 Statistical Analyses

This study's research design is quantitative which means that, at the beginning of the process, statistical data is gathered. Thereafter, appropriate analytical procedures are applied, and findings are derived from these.

The development of hypotheses is a fundamental aspect of any quantitative research project. Hypotheses represent expectations concerning potential correlations to be observed within the data set under examination. The principles of positivism underpin the design of a quantitative research project, and these stipulate that reality exists independently and objectively, regardless of the presence of an observer, and that therefore, the deductive approach is a viable way in which to derive knowledge. Furthermore, in the quantitative approach, data is typically gathered from a pre-determined number of samples, after which it is generalised to the broader population.

1.5.3 Research Methods

Within the quantitative design of this research, correlation analysis is applied because it allows the researcher to capitalise on empirical, accurate and objective statistical analysis procedures, to illuminate the relationships that exist (or may potentially exist) between different variables. Although correlation analysis is useful when attempting to discern trends within a data set, it should be noted that it lacks the capability to account for the existence of such trends, or for the nature of any causal relationships that may exist (Creswell, 2007). In the present study, the partial least squares (PLS) regression is applied, to provide insight into the correlation between corporate governance disclosure practices and several determinants. It should be noted that regression analyses are applied using mathematical models, and that these models inform us as to the degree to which a relationship exists between the examined variables. Such mathematical models, based on the data included in the data set, can predict the value of the dependent variable on the basis of independent variable values, and this illuminates the extent of any relationship between the variables considered in the study. Therefore, a quantitative model is used in this study, to analyse the collected data.

There is a more detailed review and discussion of data measurement in Chapter 5 & the research methodology in chapter 6.

1.6 CONTRIBUTION TO THE LITERATURE AND KNOWLEDGE

The study presented in this research is important to the corporate governance literature, in many ways. First and foremost, the findings from this study will help students and investors alike to more accurately perceive and understand the degree to which corporate governance practices are critical in all contexts. It is expected that the results from other studies regarding the UK and the KSA will be reproduced here, namely, that UK and the KSA listed firms with effective corporate governance practices enjoy greater access to capital and financial markets, and that their robust corporate governance arrangements safeguard them against the emergence of conflicts in the future. Additionally, that good corporate governance practices lead to greater accountability and better internal control systems.

The UK Government is strict in its requirements concerning corporate governance standards because this is the only means by which to guarantee the future growth of the firms in the economy. According to the UK Government, in the event that firms engage in corporate governance practices that conform to the guidelines, investor confidence will increase, and the economy is likely to attract a greater level of foreign direct investment (FDI). Simultaneously, shareholders benefit from the process of effective corporate governance because effective corporate governance practices protect their investments shareholders are also well-informed about the company's functioning and status. The literature indicates that more than 70% of the world's investors are willing to pay more for shares in firms that engage in effective corporate governance practices (Hussainey and Al Najjar, 2012).

Corporate governance practices in the KSA have in part arisen from lessons learned during the 2006 stock market crash. That year, the Saudi stock market achieved the classic 'bubble' state. Something of a stock market revolution occurred, because during 2006 more than 17 million people participated in the initial public offering of a petrochemical company. However, the year 2006 is also well remembered because it ignited a debate about transparent corporate governance policies. During this time, the Saudi Capital Market Authority (CMA) seemed unable to control the market, as it issued statements that worsened the situation. Factors contributing to the bubble

included a lack of transparent disclosure by listed firms, greed on the part of Saudi banks who were keen to lend, and the lack of an effective method to punish such firms.

These events led the KSA's authorities to embrace the idea of corporate governance practice as a means by which to control the behaviours of listed companies. Besides embracing corporate governance practices, it fined and shamed fraudulent firms and suspended dealers who were guilty of stock manipulation. The corporate governance literature tells us, that a country can avoid a market crash by instituting strict regulations regarding corporate governance. Appropriate corporate governance practices eliminate the chances of information destined for shareholders and investors being manipulated (Baydoun et al., 2013).

In this study, the use of the EPTM as a tool for analysis will help scholars to relate to, and understand, the various tenets of corporate governance. It is a unique model that has not been used by other scholars. Hence, it is expected that the research presented here will also indicate fruitful avenues for further investigation and study, in particular with regard to the examination of corporate governance factors additional to those covered in this study that may have a statistically significant impact on firm value. In addition, the model injects a greater quantity of information into the corporate governance literature, when compared to the historical approaches previously used to examine the subject of corporate governance (Adeyemi and Oboh, 2011).

There will be no focus on the differences between EPTM and theories, including stakeholder theory, agency theory, stewardship theory, and shareholder theory, such as claiming EPTM to be the superior theory or that it guides the firm value' and corporate governance practices' relationship. Instead, the present study proposes a new theory that not only makes it unique compared to previous studies but also helps in better explaining how firm value is affected by corporate governance practices.

Thus, authors including Beard and Dendron (2010) suggested that, following the financial crisis, comprehensive research must be endeavoured by researchers. A new model will, therefore, not only provide advanced knowledge but also substantiate the current literature.

The EPTM is capable of combining individual models to form one model that will offer enhanced understanding of work setting's decision-making processes.

Finally, it is notable that the present study comparatively examines corporate governance practices in the UK and the KSA, along with the impact that such practices in each country have on firm value. This is particularly important to recognise because the extant literature contains only comparative examinations of different countries, all the while neglecting to relate corporate governance factors to company values. In addition to this, almost all of the current, published research projects have exclusively investigated internal corporate governance practices, neglecting to examine the country's position with regard to the implementation of effective corporate governance. Therefore, a comparison of corporate governance practices, of the type presented here, is important because it will help both the KSA and the UK to understand the limitations of their corporate governance policies, and facilitate their amendment, to become acceptable, effective and practical corporate governance behaviours (Clarke 2004).

1.7 OUTLINE OF THE REMAINING CHAPTERS

The remainder of this thesis is structured as follows:

Chapter Two defines corporate governance, outlines a broad perspective regarding the concept, accounts for its importance, details its beneficiaries and discusses the diffusion of corporate governance codes and models. After this, several theoretical ideas are expounded, including agency theory, stakeholder theory, shareholder theory and stewardship theory. Finally, overviews are provided of models for ethical thinking, including the various phases of the ethical process thinking model (EPTM), its pathways and the literature that has focused on it.

Chapter Three reviews the conceptual framework and development of hypotheses. It presents the conceptual framework of the study, its research framework and hypothesis development; these apply an EPTM, which has six pathways. In this study only three different pathways are used, which are the First Pathway (the expedient pathway) (P → D), Second Pathway (the ruling guide pathway) (P → J → D) and Third Pathway (the analytical pathway) (I → J → D). For each pathway, studies that relate to the pathway are given. Chapter 3 also presents the research questions and the hypothesis for each of the pathways that are examined in this study.

Chapter Four reviews the business environments and corporate governance contexts prevailing in the KSA and the UK and presents a review of the relevant backgrounds of both countries, considering aspects such as the geography of each country, economic overview, and revolutionary oil. The chapter then presents more information about corporate governance such as models, frameworks and the external corporate governance frameworks for the KSA and the UK.

Chapter Five outlines the data employed for the research presented here, the data in question having been gathered from official company websites and annual reports. The variables to be considered are then categorised as follows: firm value variables, corporate governance variables, and control variables. Furthermore, for every category, this chapter discusses the data sources, the construction of the variables and their measurements.

Chapter Six discusses the philosophical paradigm which underpins this research, presents its philosophy, its approach, methodology, gives a review of the SmartPLS software (used for PLS regression), and presents preliminary descriptive statistical data analysis using the Statistical Package for the Social Sciences (SPSS).

Chapter Seven provides the results found after testing the main model, as well as the findings from PLS regression. In addition, the structural equation model is examined prior to the presentation of the results of the hypothesis testing.

Chapter Eight gives concluding remarks, as well as recommendations based on the findings. Key findings are summarised, limitations are discussed and further research opportunities are suggested.

Chapter 2

LITERATURE REVIEW

2.1 INTRODUCTION

The purpose of this chapter is to discuss fundamental theoretical features of corporate governance in an organisational context. As was outlined in the previous chapter, a review of corporate governance practices, so it is useful, at the outset of this research, to define what we mean by corporate governance, and to explain the concept of corporate governance in reference to commonly-used models deeply.

History contains many instances of catastrophic financial failure and business collapse that are directly attributable to weak corporate governance. Such incidents have prompted the regulatory bodies and/or the governments involved to streamline appropriate business arrangements and oversight, and to offer guidelines designed to assist companies in conducting transparent and honest operations, the ultimate aim being to bring about good corporate governance. Therefore, the discussion presented in this chapter includes corporate governance theories, codes, legal frameworks, and ownership structures for governance. The major advantages of corporate governance are also discussed in this chapter. Then, given a review of EPTM, its concepts, its phases, its the six pathways and its studies

2.2 DEFINITIONS OF CORPORATE GOVERNANCE

The roots of the concept of corporate governance lie in numerous disciplines, including sociology, economics, culture, law, politics and management. As a consequence of this, an equally diverse range of definitions exists in the literature (Mallin, 2007).

According to the Cadbury Code (1992), the term ‘corporate governance’ refers to the over-arching collection of processes by which firms are directed and managed. Corporate governance is also defined from a stakeholder’s perspective, as an understanding and institutionalised arrangements for associations between several different economic attributes and corporate contributors, all of which have either direct and/or indirect interests within the corporation. Examples include directors, managers, suppliers, shareholders, members of the general public, employees, customers, creditors, government and local communities (Letza et al., 2004).

The definition of corporate governance given by the International Financial Corporation (IFC) is comparable to that of the Cadbury Code, and highlights the idea that corporate governance is the procedure developed exclusively for the purpose of establishing direction and control over a company's operations. Corporate governance thus relates to the associations between the management of a company and that company's board of directors, the shareholders controlling the company and also the minor shareholders and stakeholders.

According to the OECD (1999), corporate governance can be regarded as the sum total of the relationships between a firm's managerial personnel, its shareholders, its stakeholders and its board of directors. According to this definition, efficient corporate governance is indispensable because it offers a framework through which the company's objectives can be defined, and the methods for performance measurement established.

According to La Porta et al., (2000), corporate governance refers to the collection of processes that investors use to secure themselves from any threat posed by the interests of a firm's 'insiders'. In the definition provided by Tricker (1984), corporate governance refers to the group of processes which constitute the focal point of corporate bodies, and this is particularly the case for limited liability corporations. This group of processes is intended to monitor and control executive decisions, to clarify the effect that the firm has on other firms and its own stakeholders, and to ensure that the firm operates in a way that complies with state regulations.

These definitions of corporate governance reflect and encapsulate concerns that companies have, about their shareholders, relationships with different stakeholders, their positions within society and the company's internal, controlling checks (OECD; 1999; Cadbury; 1992, Shleifer and Vishny; 1997). Furthermore, Mallin (2007) argues that a significant feature of corporate governance is the ability to make sure that an advanced controlling system is implemented within the company, to ensure that core checks are carried out and that the company operates in such a way that no single individual will have excessive influence over the company board's decision-making processes.

Also defined as corporate governance is the sum of associations amongst various people (such as management, employees, CEO and shareholders), which are considered to be critical in identifying the performance and direction of the company. This definition, while it concentrates on the association among the corporate governance contributors, also highlights additional factors that characterise the corporation's performance, for instance social and financial features.

Blair (1995) argues that corporate governance covers the entirety of a company's institutional, cultural and legal provisions that relate to the operations of publicly traded companies, the actual controllers of such companies and how they act to manage, and also the risks attached to the operations performed. It can be observed that in this definition, corporate governance is linked with publicly traded companies. Blair also states that corporate governance identifies the institutional, cultural and legal engagements not only for publicly traded companies, but also for non-publicly traded companies, including state owned.

From the perspective of John and Senbet (1998), corporate governance refers to the instruments used by a firm's stakeholders to ensure that the activities of managerial personnel and firm insiders are regulated, thus ensuring the long-term sustainability of the organisation. This definition highlights the idea that corporate governance should be viewed as an external mechanism, but it is important to recognise that there are various ways in which managerial control within an organisation can be facilitated, including internal mechanisms.

The concept of corporate governance is not related directly to the business of the company; however, it is about offering directions to the company. Its main function lies in monitoring and managing the management's actions at executive level, and also in meeting the legal and regulatory benchmarks for credibility as these are related to the interests of those outside the company. Every company needs to optimise (and often to improve) its governing and management arrangements. The definition explains this concept to some degree, by illustrating the differences between corporate governance and a company's core business, which is mainly articulated in association with the corporate management body concentrating on controlling the management of the company, while at the same time directing the company.

The definitions described above describe corporate governance in terms of a pattern, and account for various subjects' opinions about the challenges of corporate governance, whether these come from an economic, legal or social perspective. The definition proposed by Blair explores several predicaments that businesses frequently encounter and have echoes in other research. Dunne et al., (2003) and Mallin (2007) state that corporate governance originated as a way to minimise the risk of corporate failures occurring, worldwide. The significance of corporate governance became even more evident with the financial scandals and breakdowns that arose from weak governance structures, for example the financial crises that occurred in Asia between 1997 and 1999, the financial collapses of Enron and WorldCom that occurred the US and Europe, the failures of Polly Peck, Royal Ahold and Parmalat Maxwell (Melis, 2005 and Pettigrew & McNulty, 1995). The Enron case is regarded as one of the most important of such collapses; in this case, the failure of the corporate governance arrangements relating to the company's internally-controlled systems was due to the issue of non-executive directors, and this has been covered by Solomon (2007). A Dutch company, Royal Ahold, is considered to be a classic, and severe, example of the dangers of weak corporate governance. The company had a very prominent CEO, whose weak and bad decisions resulted in failure and the loss of more than 500 million euros. The role of institutional investors in the company was also compromised due to the CEO (Mallin, 2007).

According to Mallin (2007), corporate governance's effectiveness can also be weakened by the company boardroom showing an absence of independence, thus resulting in corporate failure. There were 13 directors in Parmalat but only three of them were independent. Considering what happened to that company, it is evident that non-executive directors who function separately from the remaining board play a crucial role. A vital role of corporate governance is not only to minimise the risk of business breakdowns it also exists to improve the credibility of a firm, to increase its access to financial services and growth from external sources while minimising the cost of debt and the chances of financial crisis (McGee, 2009, Claessens and Yurtoglu, 2013).

The objective of this study is to attempt on a comparative evaluation of the corporate governance practices as they are being applied in the Kingdom of Saudi Arabia and the United Kingdom. Since this study proposed to dwell upon the theoretical and practical aspects of corporate governance practices in these two countries, it is pertinent to adopt the inclusive definition of the concept of corporate governance in so far as it relates to the way in which a corporation is directed and controlled by the set of processes, policies, customs and practices established to ensure better financial performance of the corporation. The purview of the study also extends to the manner in which the corporate governance impacts the firm value. The study assumes that the corporate governance aspects concerning the board characteristics and audit committee has considerable bearing on the financial health and firm value of corporations. To this extent, the study aims to assess the impact of the corporate governance variables of board characteristics and audit committee on the financial health and firm value and thus tries to bring out the evidence supporting/rejecting the agency theory aspect of the definition of corporate governance. The broader definition of corporate governance encompasses the overseeing of the control and administrative functions of a corporation so that the financial health and firm value are improved and sustained. This study is based on this aspect of the definition of corporate governance. By definition, corporate governance is also expected to ensure efficient control of assets of the corporation in order to protect the interests of all the stakeholders connected with the corporation. The importance of the role of the board and the audit committee in ensuring the efficiency of such control cannot be neglected. This study covers this aspect of the definition comprehensively.

2.3 THE SIGNIFICANCE OF CORPORATE GOVERNANCE

As we noted in the first chapter, the issue of corporate governance became a topic of heated debate towards the end of the 1990s, but it is now the case that most scholars and economists acknowledge its importance as a regulatory mechanism. This section will detail five reasons why corporate governance is so significant.

2.3.1 Wave of Global Privatisation

The practice of privatising/commercialising productive is now an international trend in terms of business, including in some formerly communist countries, the economies of which have undergone modification to operate in accordance with free market forces, supported by governments. It is, effectively, mandatory in Europe to implement a free market economy and allow private companies to contribute actively in the process; this is enshrined in the rules of the European Union (EU). The move to foreground privatisation began primarily in the UK, and since 1991 some commentators have estimated the extent of privatisation within the EU at around 90%. Notably, however, by 1995 the extent of privatisation in Austria, Spain, France, Japan and Italy was put at almost 60%.

Some privatised companies that were previously state owned have been developed in order to undertake a critical function within their society, and also in the national economy. For these companies, privatisation generates key challenges for the new management and owners, arising from the effects of how the companies had previously operated and the social and economic effects of that operation. In Europe, the authorities made extensive efforts and arrangements to ensure that in such cases, management was transferred to a majority of shareholders, to assure that ongoing dominant interest, with a view to generating a proficient entity and to promote consolidation. However, in the UK a shareholder democracy was desired, and such transformation was achieved through public offers rather than private arrangements.

The configuration and benefits presented by the company's owners have a beneficial impact on the corporate governance quality within that company, and this becomes particularly crucial after privatisation, as the welfare and public interest resides with the company's governance.

2.3.2 Pension Fund Reform & Growth of Private Savings

In developed countries like the US, significant volumes of resource are reserved by government agencies in anticipation of workers' retirement, as senior citizens. This practice requires the generation of pension fund plans or similar investment vehicles, and companies dealing in these products have become increasingly strong over the time period. These firms are prime candidates for, and excellent examples of the importance of, the exercise of effective and correct corporate governance.

Soon after the subprime mortgage crises of 2007⁵, institutional investors in the US accounted for 60% of the OECD's total equity investment, a figure that rose to 76% when combined with the institutional investors of the UK. Of this figure, 40% of investment is accounted for by interests in UK and US pension programs. The managers of these programs have a duty of accountability towards their investors, particularly with regard to the public welfare interests which reside in their funds, and responsibilities concerning the retirement of financial investors. The protection and security of these investment programs demands, and will reflect, strong corporate governance.

2.3.3 Waves of Mergers & Takeovers

In the US during 1980s, and in Europe from the 1990s until now, there has been an increasing tendency for large companies to amalgamate or to be acquired by other companies within a given sector. Such takeovers may become aggressive, and companies acquired without understanding on the part of management (although not necessarily the shareholders). The taking over of big corporations leads to an assertion of power by a comparatively small number of shareholders. Furthermore, when both of the companies involved operate within the same industry, they are capable of building large companies which function as monopolies and restrict competition. When takeover is taking place across borders, it often transfers control to another political boundary. This happened in 2000, when Vodafone took over Mannesmann; they have subsequently faced allegations of corporate governance failure, due to the associations

⁵ In 2007-2010 occurred subprime mortgage crisis in the USA which contributed to the U.S. recession. The reasons were the increase in housing speculation and the rise in subprime lending.

among the management and new shareholders. The EU has now signalled its intention to regulate takeover practice.

2.3.4 Deregulation and Integration of Capital Markets

The association and integration of capital markets worldwide, and the opening of cross-border operations of equity, have led to increased capital investment and corporate governance requirements on an international scale, involving global investors who are not acquainted with the accounting and legal systems of countries other than their own. The foundation of similar corporate governance systems may take place as companies continually invest capital in other countries.

2.3.5 Economic Crises

Often, economic crises focus on weak practices of corporate governance in several countries. Such weaknesses can include corruption, dishonesty, inability to comply with relevant regulations and other, similar, states which lead to weak corporate governance which leads in turn to economic crisis. The effective function of a free market economy hinges on the free flow of information and complete exposure of companies' affairs so that customers, investors and suppliers can properly make decisions that are in their best interests. Weak corporate governance prevents the economy from booming, whereas strong corporate governance will lead to a strong and strengthening economy, and mitigated risk of economic crises.

2.4 BENEFICIARIES OF CORPORATE GOVERNANCE

Effective corporate governance conveys several advantages. For example;

- Strong corporate governance is associated with better value for the shareholders, as its leads to an increase in share price.
- Strong corporate governance application can protect the company from the failures that weak governance makes more likely, primarily:
 - Weak strategic decisions
 - Badly judged acquisition
 - Deceit, greed and lust for power
 - Inability to manage internal control
 - Inefficient board management and performance

As the benefits of strong corporate governance are identified, it becomes easier to identify the beneficiaries. Strong corporate governance works in the best interests of a company's shareholders, protecting the rights of shareholders as per the law. As the company's owners, the main responsibility of shareholders is to make sure that the company generates profits while operating according to the regulations. Hence, they must be aware of the company's operations, and have the power to control those operations.

Institutional investors are those who purchase shares, not with the primary aim of becoming an owner of the company, but in order to have dividend income, and these investors benefit from a company's strong governance. Companies are known and regarded on the basis of their performance, codes of conduct and practices, and where these are effective they lead to loyalty among customers, which in turn ultimately leads to better sales, which enhances dividend payments to investors. Hence, the price of the stock increases, which benefits investors who may enjoy an added advantage in the form of a preferential right to buy further shares.

Stakeholders, such as employees, contractors and suppliers, also receive advantages from the good governance of a company. Such stakeholders have a direct link with the company, since they are directly dealing with it, and if the company is subject to sound corporate governance this acts as a guarantee; it enhances their confidence in the company and their dedication to stay attached to the company. This strengthens the company's own stability and leads to better growth.

Last but not least, companies that apply good governance also help their society/societies, government(s) and the community/communities as their commitment to disclosure and honesty develop a trust bond among the company and people. This permits the relevant government(s) to gather more taxes, generates a tendency on the part of the authorities to favour the company (due to public acceptance and the company's commitment to corporate responsibility) and helping the firm to deal with any uncertainty that might occur. The end result is that the company grows.

2.5 THE OECD PRINCIPLES OF CORPORATE GOVERNANCE

In 1999, the OECD published its Principles of Corporate Governance (PCG), the purpose of which is to encourage all members of the international community to establish corporate governance codes which take the PCG as a standardised starting point as. Although the OECD's PCG was intended for all countries, developing countries were a particular area of focus (Enrione et al., 2006; OECD, 1999). Here, it is also worth noting that international agencies such as the World Bank and the International Corporate Governance Network (ICGN) have implemented measures to advance sound corporate governance as a standard practice across the globe.

The OECD's corporate governance group carried out a review in 2002, observing that many countries faced challenges while adopting OECD principles. It also considered the high-profile scandals that led developing countries to create a new version of their corporate governance codes in 2004. The OECD's PCG underlines the following tenets which all corporate governance codes should conform to: firstly, to guarantee that corporate governance structures are established on a viable basis; secondly, to safeguard the rights of the main ownership functions and shareholders; thirdly, to treat all shareholders without discrimination; fourthly, to ensure that stakeholder voices are incorporated into corporate governance considerations; fifthly, to engage in transparent operations and to mitigate against information asymmetry through appropriate disclosure; and finally, to establish board responsibilities. In developing these corporate governance values, the OECD took into consideration the fact that countries differ from each other in terms of their market development stage, and culture.

The corporate governance codes in many developing Arab countries have been influenced by OECD corporate governance principles. The corporate governance codes of the US and UK have also affected many developing countries in developing their own codes. Malaysia, Thailand, Singapore, Japan, Korea, India and Hong Kong all have developed corporate governance principles (Allen, 2000); but still the developing countries have limited practices and implementation of corporate governance principles (Harabi, 2007).

The principles obtained from Anglo Saxon nations are the ones that are often acknowledged. As stated by Mallin (2002), the OECD's efforts regarding restructuring the governance are associated with an idea of global merger into a national system consisting of corporate governance. Attempts to induce the acceptance of laws and regulations that were developed in developed countries, in developing nations, have frequently proved unsuccessful (Black & Kraakman, 1996).

According to Kapardis and Psaros (2006) the effectiveness of the Anglo-Saxon model in developing countries has four requirements, which are; 1) a highly sophisticated and liquid security system 2) timely, reliable and accurate flow of information into the market 3) reduced concentration of ownership 4) a highly developed legal infrastructure, able to fight insider dealing and wealth transfer. Thus, it seems ideal to specify criteria to be adopted by emerging countries wishing to adopt the Anglo-Saxon model, so that effective outcomes can be generated.

2.6 CONVERGENCE OF CORPORATE GOVERNANCE CODES

Many countries, from all parts of the world, have taken inspiration from the Cadbury Report to develop their individual codes of corporate governance (Tiker, 2009; Aguilera and Cuervo-Cazurra, 2009) and to support and establish implementation of that corporate governance model (Enrione et al., 2006). Other sources have made other suggestions; the idea of the dual two-tier⁶ board appears in the Vienot Report (developed by the French Government in 1995), and other codes that have arisen interest worldwide include the Cromme Code (developed in Germany in 2002) and the Norby Report, a (non-mandatory) code arising from which was introduced in Denmark in 2001. Sixty-eight countries, including developing nations and transition countries, had developed corporate governance codes by 2008 (Aguilera and Cuervo-Cazurra, 2009). In addition to that, the OECD and World Bank have encouraged the countries all over the world to adopt corporate governance codes.

⁶ A Second Level or Dual Board System is a system by which to structure corporations. It includes two separate management boards that work together for business management. The structure comprises two boards, the Directors' Board and the Supervisory Board, each serving a special purpose.

2.7 MANDATORY VERSUS VOLUNTARY

In the US, the approach to corporate governance implementation has usually been to make it mandatory. In the US, this has been largely fuelled by financial scandals mandating a corporate governance framework can reduce these scandals (MacNeil and Li, 2006). As noted by Solomon (2007) and Aguilera and Cuervo-Cazurra (2009), a voluntary approach has been instituted in the UK and its implementation has been persuaded by defining the advantages and disadvantages of adhering and non-compliance, respectively, to a corporate governance code that is effective. This approach is underpinned by three assumptions, which are; 1) that it permits flexibility on the part of companies, to make adjustments and incorporate the governance mechanism that suits them best 2) the ability of the legal model to serve the specific agenda of corporate governance, and 3) the ability of financial markets to assess the competence of corporate governance codes (MacNeil and Li, 2006). In the US and UK, the corporate governance frameworks focus on issues that are relevant in all countries, regardless of the different approaches that every country has decided best serves the interests of corporate governance. That being said, Saudi Arabia, and other developing countries that have many social and cultural differences from European countries, should consider those differences while adopting corporate governance practices. Different models of corporate governance will be discussed in the next section.

2.8 CORPORATE GOVERNANCE MODELS

Of the many determinants of a corporate governance model, a state's legal environment and a firm's ownership structure are particularly important considerations (La Porta et al., 1997; Solomon, 2007; Aguilera and Jackson, 2010; Shleifer and Vishny, 1997). The purpose of this section, therefore, is to examine these two factors.

2.8.1 Legal Environment

For economic development and corporate governance to occur in a country in an effective way, a prerequisite is an appropriate legal environment, namely, a system which values impartial enforcement of the law and which safeguards the rights of individuals and organisations to property, ownership and independence (La Porta et al., 1997). It is clear that a country's system of corporate governance is significantly affected by the structure(s) of ownership and legal framework of the country. However,

other factors, including the labour market, legal environment, financial system and capital market framework within the country can also affect the classification and nature of the corporate governance model (Solomon, 2007; Maher and Andersson, 2000).

According to Berle and Means (1932), the ownership structures in developed economies such as the UK and USA have become very dispersed, and the rights of the minority shareholders are assured by common laws in these countries (Mallin, 2007). This situation encourages the investors to invest in markets that have strong mandates to protect those investors; in contrast, markets with weak protection mandates for minority shareholders which includes developing markets discourage the investors from participating in such markets (La Porta, 2000). From this, it is clear that the laws adopted by a country greatly affect the extent of investors' protection, as either adopted laws encourage investors to make investments and that leads to highly dispersed ownership, or they discourage them from investing, and that reduces the investors' protection level. For example, the civil law in France discourages investment and as a result in that country there is a strong tendency for structures whereby ownerships is concentrated with controlling shareholders or family. La Porta et al. (1997) have found a connection between investor protection levels and the legal framework of the nation. According to many authors, the extent of investor protection depends on the legal framework of a country, and indeed the civil law of France is weak in this regard. The UK and the United States, with common law codes, offer strong protection for their investors, while the law adopted by Scandinavian nations and Germany stands somewhere between the two. Moreover, Saudi Arabia has adopted the civil law of France, and thus is expected to possess weak investor protection mandates (Koraytem, 2000; Sourial, 2004). Those countries with weaker legal frameworks usually compensate their companies with stronger corporate governance practices (Klapper and Love, 2004).

Aguilera and Cuervo-Cazurra (2009) examined the application of corporate governance practices in several states, noting that countries with common law systems implemented such practices at an earlier stage than their counterparts reliant on civil law. Furthermore, the researchers noted that countries characterised by developed markets are more likely to establish a greater number of corporate governance regulations, which stems from the foundational belief that mature capital markets have a strong impact on the advancement of corporate governance practices.

Zattoni and Cuoma (2008) have investigated corporate governance frameworks in 60 countries and classified them according to their legal framework (civil/common law). These authors observed that the countries that have adopted civil law also possess weaker recommendations for corporate governance frameworks, when compared with countries that apply common law. These countries are also different in terms of strictness, coverage and scope of recommendations. Moreover, common law nations have adopted the corporate governance practices earlier than civil law nations and offer highly lenient recommendations. In common law nations, board structure, and evaluation of the board members, are key areas of focus in corporate governance practices. On other hand, the main elements of focus in corporate governance practices where civil law predominates include shareholder rights, conflicts of interest and employees' roles. It is clear that guidance on corporate governance practice issued by civil law nations are published not for the improvement of governance practices, but for reasons of legitimacy.

2.8.2 Ownership Structure

The literature suggests that the form in which corporate governance appears, is determined in large part by the concentration of a firm's ownership (Shleifer and Vishny, 1997). In fact, the type of corporate governance a firm engages in is determined by the nature of its ownership, and two categories are created; the outsider model of corporate governance; and the insider model (Short et al., 1998). With respect to the insider model, the voting power and ownership of the firm rests almost entirely with important shareholders, that is to say majority shareholders and, in the case of family-owned enterprises, family members (Maher and Andersson, 2000; Solomon, 2007). As has been noted by Maher and Andersson (2000), it is also the case that mutual funds, institutional investors and banks perform a critical function with regard to the insider model of corporate governance. Countries in the Middle East and North Africa (MENA) region are strongly attached to the insider model, as are several Asian countries and states on the European continent (Bhasa, 2004; Claessens et al., 2000; Sourial, 2004). It is particularly noteworthy that, when compared to the outsider model of corporate governance, the insider model predominates in the international community (La Porta et al., 1998; Maher and Andersson, 2000).

One of the defining characteristics of the insider model is the fact that management and ownership are closely intertwined. Clearly, this increases the likelihood of self-interested operations, where the majority shareholders can exercise a high degree of opportunism against minority shareholders (Berglof and Pajuste, 2003; Young et al., 2008). It is commonly the case that countries characterised by the predominance of the insider model of corporate governance are characterised by underdeveloped capital markets, especially when compared to the outsider model (Maher and Andersson, 2000; Coffee, 2002). Nevertheless, the defining strengths of the insider model stem from the way in which it is not impacted by short-term market demands, while long-term investment is promoted through ownership concentration (Maher and Andersson, 2000; Claessens and Fan, 2002; Solomon, 2007; Mallin, 2007).

In outsider model, ownership and voting power within the listed firms is dispersed among many investors (Mallin, 2007). According to Short et al., (1998), the UK and the US are countries where management and ownership are greatly separated from each other (Denis and McConnell, 2003; Solomon et al., 2002). The roles of banks, mutual funds and institutional investors are very important in outside model (Maher and Andersson, 2000).

2.9 CORPORATE GOVERNANCE THEORIES

The literature, old and new, contains many theories in relation to corporate management, and these include agency theory, stakeholder theory, shareholder theory and stewardship theory to name but a few. Together, these theories have influenced the growth of corporate governance internationally. These theories initially emerged as western theories but were soon implemented across the globe.

2.9.1 Agency Theory

According to Jensen and Meckling's (1976) definition, which is illustrated in Figure 2.1, an agency relationship refers to the contractual connection that arises between two individuals when one (i.e., the agent) engages in activities on behalf of the other (i.e., the principal). Owing to the contract, the principal assigns some portion of their obligations to the agent, whose responsibility it then becomes to satisfy the interests of the principal (Culpan and Trussel, 2005). The underlying assumptions are that a

divergence of interest exists between principal and agent (Hill and Jones, 1992) and that people are individualistic (Davis, et al. 1997).

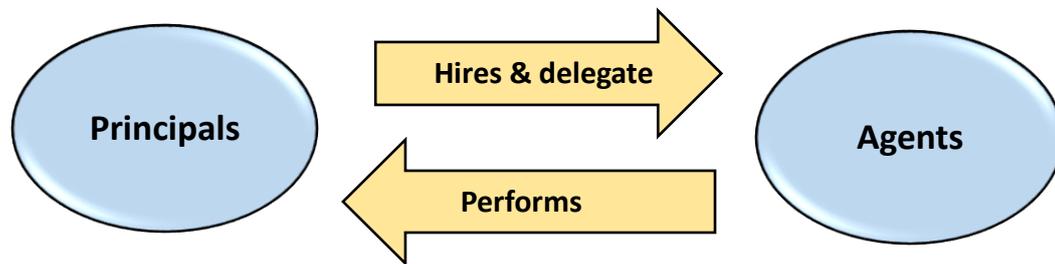


Figure 2.1 “the agency model (Jensen and Meckling, 1976)”

Information asymmetry can occur when management (or the agent) gains access to superior information as compared to that accessed by the principal (Arnold and de Lange, 2004). This can lead to inability on the part of the principal to control the actions of their agent, because of distinctions in ownership and control of the firm’s business. This can cause problems in the agency relationship (Morris, 1987). Arnold and de Lange (2004) argued that two agency problems in particular can take place when uncertainty arises and information is incomplete.

The first problem is often dubbed the adverse selection problem, and it arises when the principal is not able to identify whether the agents can perform the task for which they are paid. Eisenhardt (1989) has argued that although an agent may claim that he possesses certain inherent skills and qualities, complete verification may not take place until that agent has actually undertaken the task. The second problem is known as the moral hazard problem. This problem arises when the principal is uncertain whether the agent can perform to the fullest of his abilities and capabilities.

Turnbull (1997) has argued that in countries where there is a tendency towards dispersed ownership, such agency problems are acute. This is because the investor does not have sufficient time to thoroughly oversee everything associated with the organisation or his investment in an organisation. Hope (2003) argued that in East Asian companies, the separation of management and ownership is unlikely. Therefore, (as has also been observed by Ishak, 2004) it is less likely that conflicts will arise between management and shareholder. Choe (1998) argued that in East Asia the trend is for concentrated ownership, which can give rise to conflicts of interest between major shareholders and other stakeholders. Moreover, the interest of minority shareholders may be over-ridden in such situations. Jensen & Meckling (1976) observed that

prospective minority shareholders in such contexts realise that the interests of owner-managers are very distinct from those of minority shareholders and this is reflected in the price they pay for shares. This observation has received support from Khatri (2001) who stated that, in an insider system where there is concentration of ownership, conflicts are bound to arise between minority shareholders and controlling blockholders.

Jensen & Meckling (1976) have observed that there are several ways whereby the principal in an agency arrangement can reduce the divergence of interests. This reduction is also referred to as preventing opportunistic behaviour. Firstly, the principal can arrange for monitoring of the agent, which can ensure that they are pursuing the principal's interests only. Asian companies are monitoring the performance of agents through outside auditors (Claessens and Fan, 2002). Claessens & Fan (2002) also pointed out that, by employing the services of external auditors, companies can develop a better regime of governance which ultimately increases the wealth of shareholders. Secondly, the principal can also arrange for compensation regimes, for example agents may be called upon to compensate the principal in the event of any loss. However, even when such bonding and monitoring activities are undertaken, there can still be a reduction in the welfare of the principal, which is referred to as residual loss. Thus, the agency cost is the total of bonding cost, monitoring cost and residual cost.

Previous research has indicated that monitoring costs can be lowered by the disclosures of/within annual reports, as well as by the provision of bonding operations whereby agents prove that they have been working in line with the objectives of the principal (Raffournier, 1995; Cooke, 1993; Hossain, et al. 1994).

Healy and Palepu (2001) considered the potential value of stock compensation, i.e. they suggested that managers who are entitled to stock compensation are motivated to disclose information in annual reports on voluntary basis, mainly to enhance the image of the company and to keep the principal informed. This can also be applied with respect to corporate governance i.e. the voluntary disclosure of corporate governance information whereby managers can so disclose voluntarily, to demonstrate the efficiency of the organisation in the market and enhancing the confidence of the investors. (Miles, 2005).

2.9.2 Stakeholder Theory

Stakeholder theory, formulated for the purpose of broadening investigations into corporate governance, is often used alongside or instead of agency theory, owing to its explanatory power. As stated by Donaldson and Preston (1995), stakeholder theory essentially accentuates firms' obligations, stakeholder's intrinsic value, and that all stakeholders' interests have equal importance (see Figure 2.2). Stakeholder theory stipulates as a necessity that managerial personnel have to consider the interests not only of shareholders, but also of stakeholders, when engaging in decision-making. One of the points in favour of the validity of stakeholder theory is the fact that the OECD's conceptualisation of corporate governance (cited in Chapman, 2006) explicitly relies on the tenets of the theory. It is noteworthy, however, that the concept of corporate governance applied by the OECD was relatively narrow, and so the purpose of corporate governance practices was largely to ensure that agency problems could be safeguarded against. But recent years have witnessed a considerable expansion in the scope of the responsibilities each firm possesses, and so a conceptualisation of corporate governance grounded in stakeholder theory is far more appropriate and, as such, has proliferated (Kulik, 2005). It should be noted, however, that because the group of stakeholders relevant to a firm is so extensive and diverse, analysing not to mention taking into consideration the interests of each stakeholder group can contribute to ineffective and unfocused firm performance (Vos, 2002).

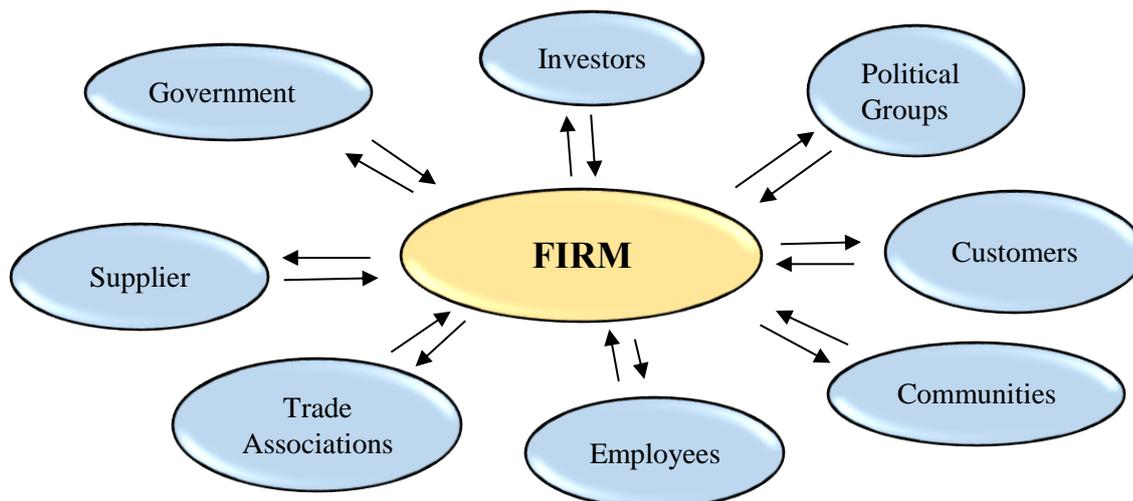


Figure 2.2 "Stakeholder theory (Donaldson and Preston, 1995)"

According to Donaldson and Preston (1995), stakeholder theory should be used to augment the decision-making processes that managers engage in. While the moral processes and outcomes which lie at the centre of the claims of stakeholders are intrinsically valuable, it is difficult to pin these processes and outcomes down in an accurate way. In the event that these processes and outcomes are reliant on the degree to which an external auditor is impartial, then this matter becomes even more difficult.

2.9.3 Shareholder Theory

Shareholder theory, advanced by Friedman (1970), foregrounds the moral and legal responsibility a firm has to satisfy shareholder interests, and posits that its sole responsibility is to the maximisation of profitability (see Figure 2.3). It implies the protection of shareholders of the organisation and focuses on protection of their rights and their interests. Shareholder theory implies that the shareholders of the organisation should be treated fairly; shareholders are regarded as the primary group of rights-holders with respect to the organisation. It is notable that the OECD's PCG emphasises the role of shareholder protection and states that it should be a fundamental quality of all corporate governance frameworks.



Figure 2.3 “Shareholder Theory (Milton Friedman 1970)”

At the same time, it is worth acknowledging that shareholders themselves play a partly determinative role with respect to the corporate governance framework, since they contribute to the achievement of an organisation's objectives, doing so in concert with the firm's managerial personnel. Hence, given the consequential nature of shareholder behaviour, their role regarding matters of corporate governance should be correspondingly consequential. That being said, shareholders rarely exercise the same degree of control that managerial staff members do, and it is often the case that shareholders cede their right to vote, giving directors even greater decision-making power. Although this is common practice in many firms, shareholder theory emphasises that those individuals who have invested in the firm have a legitimate seat at the decision-making table, and that this should never be overlooked. In particular, members

of a firm's board of directors, as well as managerial personnel within the firm, must exercise control and take care to safeguard shareholder interests.

It is also important to note who holds majority shares in an organisation, and who holds minority shares. The shareholders can be individuals or group of individuals; there may also be another corporate organisation holding shares in a corporate organisation. Those who control more than 50% of the shares in an organisation are known as majority shareholders. Those who possess fewer than 50% of shares in an organisation are known as minority shareholders. It is important to identify these two groups, in order to understand shareholder theory. In view of this, it is important to recognise that the OECD's PCG requires that all corporate governance codes should treat shareholders fairly (not excluding minority shareholders or foreign shareholders). As a consequence of this, measures should be in place to ensure that any shareholders whose interests are violated can pursue remedial action.

In this regard, the shareholder theory covers not only the relationships between shareholders and organisations, but also those between different shareholders. Criticism has also levelled at the abuse of power which can be committed by the majority shareholder, particularly with respect to voting procedures during general or extraordinary general meetings of the organisation. This brings the power of cash to the forefront, as compared to the power of 'rights'. A further criticism of shareholder theory is that it is likely a majority shareholder would fight against a framework of corporate governance that ensures strict corporate compliance, because such framework would ensure extra protection for the minority shareholder(s). Nevertheless, in numerous developed countries, the law stipulates that the interests of minority shareholders must be safeguarded.

2.9.4 Stewardship Theory

Stewardship theory, derived from findings in psychology and sociology, refers to the way in which a steward (in the organisational context, a manager or executive) who appropriately safeguards and, furthermore, augments shareholder wealth (as a consequence of effective firm performance), has maximised their utility/function (Davis et al., 1997). When compared with agency theory, a stark contrast appears in the way that stewardship theory collectivises the objectives of executives and the firm, in a manner quite unlike the individualistic nature of agency theory (Donaldson and Davis, 1991). According to the stewardship model, stewards are motivated and satisfied when the organisation attains success. From the perspective of agency theory, people and employees are mere economic beings, and this status results in the suppression of the individual's aspirations (Agyris, 1973). On the other hand, stewardship theory places emphasis upon structures that can empower the steward and provide high degrees of autonomy, based on trust (Donaldson and Davis, 1991). This perspective also focuses on the capacity of either executives or employees to act more autonomously in the pursuit of one goal to maximise the shareholders' returns. Davis et al., (1997) supported this model, stating that this perspective minimises the costs usually directed towards controlling and monitoring behaviours.

For the purpose of safeguarding their status as decision-makers within a firm, it is often the case that directors and executives will seek out the most sustainable and profitable path for the company itself, rather than simply choosing path that is the most sustainable and profitable for themselves (Daly et al., 2003). As will be clear to the reader, this has a net positive impact with respect to firm value, shareholder value and the functional utility of the executives and/or managerial personnel. As indicated in Figure 2.4, the individual who holds to the tenets of stewardship theory considers that firm performance has a direct impact on the perceptions of individual performances. This position is also supported by Fama (1980), who argues that directors and executives also manage their careers in light of a goal, which is to be perceived as effective stewards of their own companies. In contrast, according to Shleifer and Vishny (1997), managerial personnel return dividends to shareholders for the purpose of establishing a positive reputation for the company and, furthermore, investor confidence. As such, in the hope of acquiring further returns on their investment, shareholders are likely to hold their position (retain their investment) in the company, thereby promoting the firm's

activities. Notably, corporate governance practices in Japan are characterised by the stewardship model, since employees typically adopt the role of steward by forgoing self-interest to achieve organisational goals. Furthermore, in the stewardship model or perspective, there is a strong focus on the unification of the role of the CEO and that of the chairman, which is made in order to reduce agency costs as well as to gain greater role for chairmen as stewards of the company. It is obvious that when matters are administered from this perspective, that the interests of the shareholders will be better safeguarded than may be the case in other contexts. According to Donaldson and Davis, it has been established that shareholders' returns have been better improved by using both stewardship theory and agency theory combined, rather than applying them separately (Donaldson and Davis, 1991).

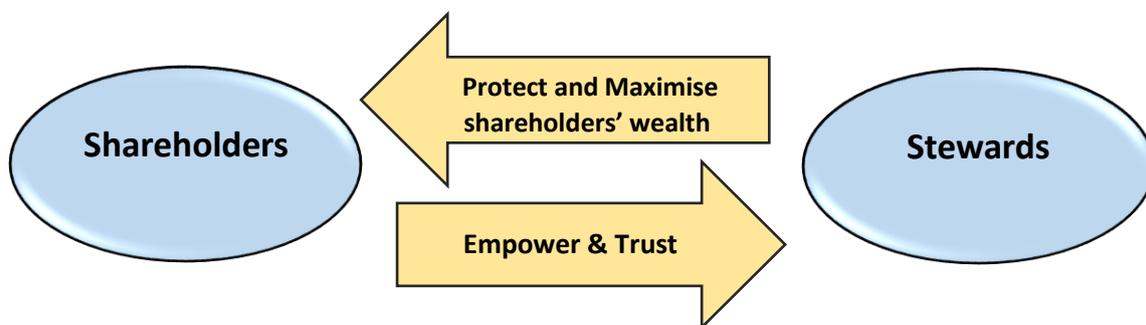


Figure 2.4 “the stewardship theory (Davis et al., 1997)”

2.10 ETHICAL PROCESS THINKING MODEL (EPTM)

Corporate governance influences and relates to decision-making from an ethical perspective, and in this regard an Ethical Process Thinking Model (EPTM) can be of great use. Decision-making, according to an EPTM model, is an information-processing function that takes a multi-stage approach. The EPTM can help individual leaders and organisations to be cautious about and consider the ethical implications of their decisions and choices (Rodgers et al. 2009). The ETPM process starts with individuals expressing their views concerning a future course of action. This model has the advantage of helping the decision-makers to understand the reasoning that lies behind individuals having chosen the particular information that supports their decision, and in a similar way having chosen the omission of specific information that is not supportive of their decision. The EPTM approach facilitates the identification of those observations and values that have been relied upon by individuals in taking particular positions on various issues. This model can also be used in the later stages of decision-making

processes, to identify materials which support the positions taken by the individuals. In addition, the EPTM model can be of use to individuals in analysing ethical situations and suggesting alternative, ethical, positions by providing different decision-making pathways. The literature suggests the application of an EPTM approach in several contexts including within organisations, auditing, education and financial markets (Foss and Rodgers, 2011; Rodgers et al. 2009; Rodgers et al. 2013).

According to most moral philosophers, ethical conventions are the products of preferences, rules and tenets (Rodgers, 2006). Ultimately, the ideas that we as human beings form, about behaving in one way rather than another in any given situation, stem from the types of value we have. However, and more importantly in this context, those ideas flow also from the nature of the values that the society in which we live, relies upon to function. Consequently, it is possible to illustrate the decision-making processes of each individual, by way of an organised pathway. It is important to note that the nature of the pathways that are employed in the decision-making process may vary, for example, during the performance of daily activities, and the nature of the pathways drawn upon depends on the environment (in particular, the information it contains), on how the environment is perceived, and the experiences of the individual (which, in turn, inform their judgement). An overview of this is given in Figure 2.5. The EPTM draws on a distinctive approach when attempting to illuminate how decisions are made (Rodgers, 2006), and this has allowed it to investigate rationalisations of certain behaviours (Rodgers, 1997). Particularly noteworthy, the EPTM has been used in the past to examine the behaviour of loan officers, and the more general areas of auditing and business ethics (Rodgers et al., 2009).

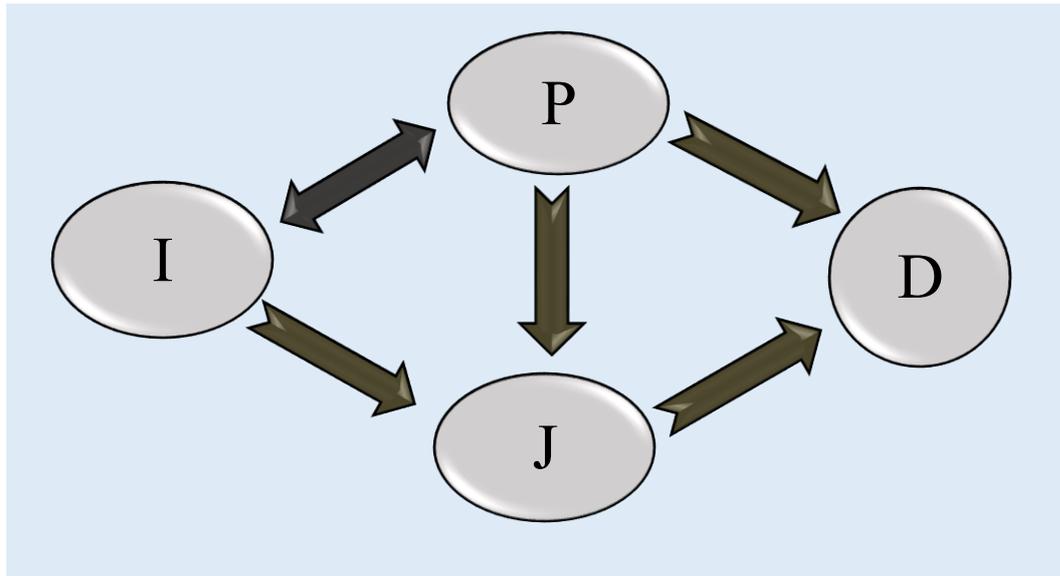


Figure 2.5 Ethical Process Thinking Model (EPTM) Where **P** = Perception, **I** = Information, **J** = Judgment, **D** = Decision Choice (Rodgers 2006, p.5).

2.10.1 The Phases of EPTM

The EPTM approach works on the basis of approaching the decision and/or choices from four different perspectives, or phases. These are perception, information, judgment and decision choice (Foss and Rodgers, 2011).

2.10.1.1 First Phase – Perception

Perception is the phase of an EPTM process in which the decision-making environment is framed through perceiving the information, which might affect the decision-making abilities of the decision maker. This information comprises that which is available through internal, as well as from external sources (Rodgers, 2006). The decision maker's perception can be influenced by many informational sources, such as competitors' actions, government legislation and changes in economic trends. The perception phase has interdependence with the next phase, which is information, and this interdependence can help with recognition of the biases of the individual decision makers (Kleindorfer et al. 1993, quoted in Rodgers and Gago, 2006). The interdependence of the perception and information phases can help the individuals involved to explain their reasons for choosing certain information.

2.10.1.2 Second Phase – Information

During this phase, the information collected is stored for use in different decision-related contexts. In this second phase of EPTM, pieces of information relating to the decision choices are collected; such information may be financial or non-financial. Whilst processing the information collected, it is important to recognise the relative context to which the information is pertaining, the time period at which the information was presented and the environmental situations of the organisation. Relevant information needs to be stored, for use at other stages of processing.

2.10.1.3 Third Phase – Judgment

The judgment phase is that in which the interaction of knowledge structures, usually referred to as ‘schema’, takes place. In this phase, information is analysed, in order to weight key information items, so that alternative decision and choice options can be compared as part of the process for making the final decision (Rodgers and Gago, 2006). Investigatory and analytical precepts are employed by the decision maker, so that the cause of the problem can be diagnosed. Effective diagnosis and judgment requires both inductive and deductive reasoning, and the development of alternative decision/choice opportunities is also covered in the judgment phase. The decision maker can appraise the alternative choices using any single norm or approach or may use a combination of different methods.

2.10.1.4 Fourth Phase – Decision Choice

The decision choice phase is the fourth phase, and this involves choosing the best course of action from among the options available. This phase may involve three different kinds of activity; choices, evaluation and constructions (Yates, 1990, quoted in Rodgers and Gago, 2006). In the case of choice, the decision maker is presented with various alternatives that are well-defined and will be entrusted with the responsibility of choosing one of these alternatives, by implementing their abilities to take a decision that meets the organisational objectives. Evaluation is based on the consideration of the worth of the alternatives available (Rodgers and Gago, 2006), while constructions represent decision choices in which the decision maker attempts to assemble the most appropriate alternative from many alternatives presented to them. Sometimes, the decision maker has to consider the best aspects of each alternative and combine them.

2.10.2 Pathways in EPTM

2.10.2.1 The Expedient Pathway (P→D)

This thought process describes reaching a decision based on perception only as opposed to also relying upon information. Furthermore, the judgement phase is omitted, which comprises adopting an analytical and evaluative approach (see Figure 2.6). Therefore, an expedient pathway is characterised by reaching a decision under the following conditions: in the absence of available or relevant information; contending with significant time constraints; and having already acquired expert knowledge or skills in this specific field. According to Rodgers (2006), the time and energy expended in indecision, hesitancy and apprehension can be reduced and used instead to greater effect by engaging in alternative everyday pursuits.

The latter author cites an interesting case example to demonstrate the way in which decisions are reached using this approach. Rodgers (2006) proposes that there is a low probability of an individual being abducted or captured as a hostage. However, in the event of this occurring, the chances of survival are high. While undoubtedly this is an extremely difficult ordeal to be subjected to, nevertheless, those who have endured these unpleasant experiences have maximised the resources available to them in response to such adversity. When a television broadcast or other media outlet informs the public that militia have taken a civil servant hostage, the typical immediate response is to denounce their actions. Thus, these rebel forces are perceived as evil perpetrators of terrorist activities. Those hearing this news are less likely to establish whether the hostage was a Good Samaritan or alternatively a murderer in his or her own right. In addition, audiences tend not to take cognisance of the fact that this individual may have enlisted in a militant group as a life-saving measure. Based on the perceptions typically elicited, Rodgers (2006) claims that the general public condemn the activities of the militia in relation to the decision choice they have made. The expedient pathway (P→D) clearly illustrates the way in which decision-makers are informed solely by their perceptions, and they neither rely upon information nor judgement functioning, such as analysis and evaluation, to reach a decision. Essentially, the information and judgement components are either absent or disregarded when adopting this decision-making approach. Thus, a decision choice is based on a rapid and immediate response. Notwithstanding its limitations in terms of reaching the best possible decision, Rodgers (2006) contends that in some contexts it may be the most appropriate approach to adopt.

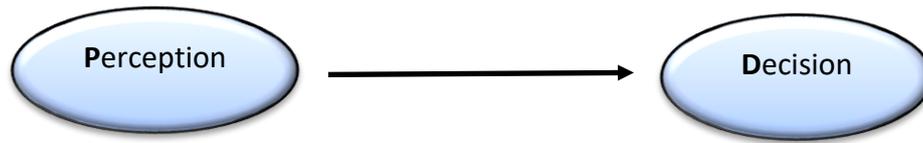


Figure 2.6 **P→D** “Process thinking is that decision is made based on perception only” Rodgers (2006, p.15).

2.10.2.2 The Ruling Guide Pathway (P→J→D)

This thought process model is founded on the premise that decision-makers rely upon their perceptions, in combination with judgement functioning to conduct an analysis and evaluation, prior to reaching a decision (see Figure 2.7). This approach is adopted by those who choose to exclude information inputs either because of lack of availability or irrelevance within the particular setting. In addition, this pathway is regulated by a combination of decision-maker-led rules and laws, which can be both internally and externally driven. Rodgers (2006) contends that this process can lead to either positive or negative outcomes, depending on the situational context.

Rogers (2006) cites the following case example, having undertaken a comprehensive examination of the ruling guide pathway (P→J→D). It focuses specifically on purchase decision-making within the context of door to door sales, whereby the potential customer is offered a significant price reduction upon agreeing to purchase the goods or services with immediate effect. The perception the consumer forms is shaped by the engagement process at the door with the salesperson, followed by judgement which manifests as appraisal of his or her level of trustworthiness, irrespective of the information provided in relation to the goods or services on sale. If a salesperson is perceived to be dishonest, then there is a lower probability that the consumer will engage with him or her, even if the product on offer is a strong, well-known brand. Conversely, there is a higher likelihood that a sale will occur if a young student is selling a product as part of a school fundraising initiative, despite the product being widely regarded as exorbitantly priced. In this specific instance, the key contributory factor instigating the purchase decision choice is that the student is perceived in a positive light, and, therefore, judged to be legitimate. This example, as outlined by Rodgers (2006), clearly illustrates that the judgement formed by the decision-maker is shaped by the perception he or she holds, which subsequently influences the decision choice made.

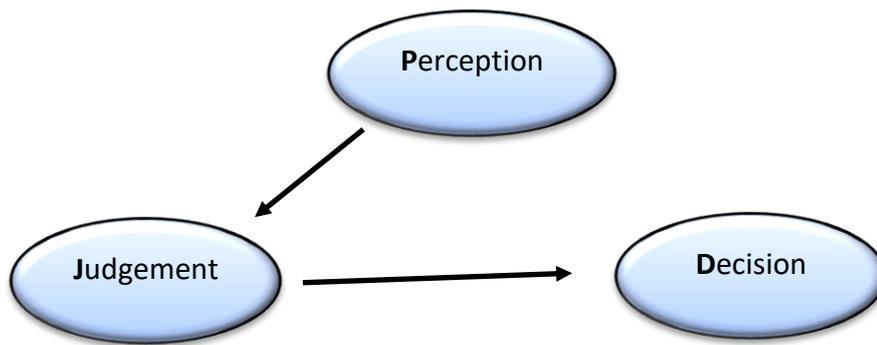


Figure 2.7 **P→J→D** ““Process thinking is based on Perception to Judgment to Decision”” Rodgers (2006, p.18)

2.10.2.3 The Analytical Pathway (I→J→D)

The analytical pathway adopts a systematic and programmatic decision-making approach, which includes: establishing the nature of the problem; clearly delineating all determinants; assigning a value to each determinant; identifying all other available options; assessing and rating other possible options; and finally choosing the most worthwhile option. This process is based on the premise that the information used to inform the decision choice is relatively reliable and appropriate within this context. In addition, this information is regarded as making a significant contribution to reaching a final decision (see Figure 2.8).

The key components of this decision-making process can be illustrated in the following scenario, whereby a consumer buys a car by signing up to an instalment-based loan repayment scheme. Unfortunately, however, information becomes available that this person has defaulted on this agreement by failing to keep up the repayments over a four-month period. This results in the retailer asserting the right to reclaim possession of the vehicle, along with taking a number of other steps in line with the terms of the credit loan agreement.

This response is evoked unilaterally, irrespective of the personal difficulties purchasers may be experiencing at the time, for example, having to pay unexpected medical expenses. The retailer involved in this transaction is solely dependent on information conveyed through the company’s Accounts Department, which has signalled that a specific purchaser has reneged on four consecutive payments. Rodgers (2006) states that a final decision choice is made to repossess the vehicle, following close analysis and review of the validity of the information obtained, which is reflective of the judgement stage. The latter author, in presenting this decision-making pathway,

underlines the important role information and judgements collectively play in making decision choices. In contrast, this response is not based on experience or the development of a deep understanding or strategic vision, which is incorporated within the perception function. Essentially, a systematic approach is adopted instead, without availing of the advantages associated with involving perception in the decision-making process.

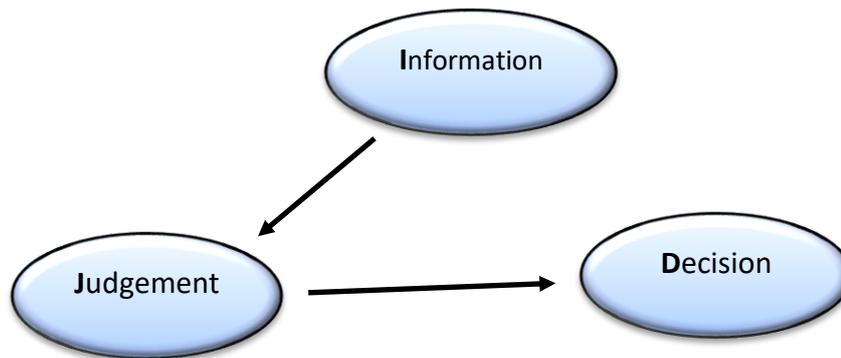


Figure 2.8 **I → J → D** “Process thinking goes from Information to Judgment, then to Decision” Rodgers (2006, p.21)

2.10.2.4 The Revisionist Pathway (I → P → D)

The revisionist pathway (I → P → D) depicts an informally organised setting, where all accessible information may be drawn upon to shape individual perceptions, prior to reaching a decision. Within this context, the information available may be all-inclusive, or alternatively very limited. Such lack of certainty surrounding events presents as a challenge in terms of systematically organising, rating or ranking the information available (see Figure 2.9). Consequently, as a revisionist pathway is extremely reliant upon information which is ever-changing in nature, this leads to ongoing adjustments needing to be made to the way in which situations are perceived.

Individuals need to achieve high physical fitness levels in advance of undertaking a challenging outdoor activity. Those falling within a healthy weight range and who engage in regular exercise are generally more likely to be in a good physical condition prior to embarking on this type of venture. One scenario to illustrate this thinking process is a woman who decides to undertake a nature trail trek over a particular weekend. In preparation, she enlists the support of a professional guide, who is currently employed in an outdoor equipment and clothing store. He subsequently recommends that she buys a number of items prior to setting out on this journey. She agrees to

purchase these goods, in light of the fact that this woman perceives the guide to be well-informed in this area.

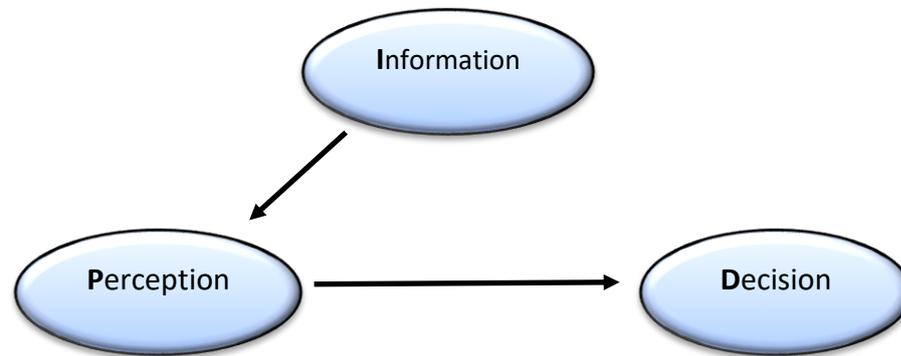


Figure 2.9 $I \rightarrow P \rightarrow D$ “Process thinking goes from Information influencing Perception and then to Decision” Rodgers (2006, p.24)

2.10.2.5 The Value Driven Pathway ($P \rightarrow I \rightarrow J \rightarrow D$)

The value-driven pathway ($P \rightarrow I \rightarrow J \rightarrow D$) describes the way in which a person’s perceptual framework assists in choosing and directing the information they apply to inform judgemental functioning. A number of factors impact upon this process, including associated complications, information-processing constraints and the degree of congruity between perception and accessible information (see Figure 2.10). Therefore, in engaging in this thinking process, an individual will have to alter his or her perceptions in order to choose the information required for analysis and decision-making purposes.

This thinking process model begins with perception shaping information, followed by judgement and finally reaching a decision.

Prior to casting their vote in a national election, many of the electorate have preconceived perceptions of the nominees seeking election. For example, they will have already formed views on their general leadership ability, as well as traits such as their affability and ethical behaviour. While details pertaining to the candidates may emanate from a number of sources, including print material, online media and through radio and television advertising campaigns, ultimately each individual voter will have to decide on the relevance and accuracy of this information.

Notwithstanding this, many of the electorate rely heavily upon their perceptions to determine the type of information they regard as true, and which they subsequently apply for analytical purposes. Consequently, voters' form framed feelings or perceptions in relation to these political candidates, along with establishing precisely what information they will select in order to carry out an analysis, as part of the judgement stage. Finally, they arrive at a decision choice by selecting a candidate whom they wish to vote for.

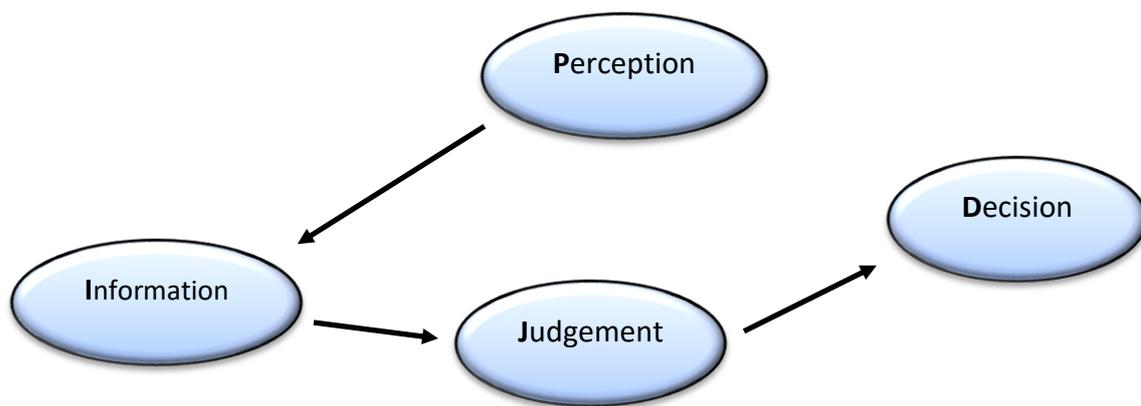


Figure 2.10 **P→I→J→D** “Process thinking starts with Perception influencing Information then to Judgment then route to Decision” Rodgers (2006, p.27).

2.10.2.6 The Global Perspective Pathway (I→P→J→D)

A global perspective pathway (I→P→J→D) is founded on the premise that obtainable information impacts upon the decision-making process, by shaping patterns of information search behaviour and preferences. This occurs prior to engaging in analysis or forming a judgement, in order to organise, rank and rate this data (see Figure 2.11).

The careful assessment of whether to avail of plastic surgery captures this thought process. Typically, an individual with no previous history of this treatment or knowledge of the area acquired through friends or those within the medical profession will initially undertake a research process. This generally involves sourcing a plastic surgeon, as the patient will not have formed any prior perceptions of doctors working within this field. These perceptions subsequently begin to develop and evolve, having located a number of practitioners through online searches, arranging appointments to see them and having viewed photographs of the treatments they have previously performed.

This information gathering process will shape this individual's perception of the surgeons he or she engages with. Gradually, over the course of a number of appointments, enhanced information quality will shape the patient's perception of each individual doctor. The patient will subsequently undertake an analysis of the doctors' portfolios, as well as the feelings each doctor evokes. Following analysis or judgement formation, the patient will decide upon whom he or she wishes to carry out the surgery.

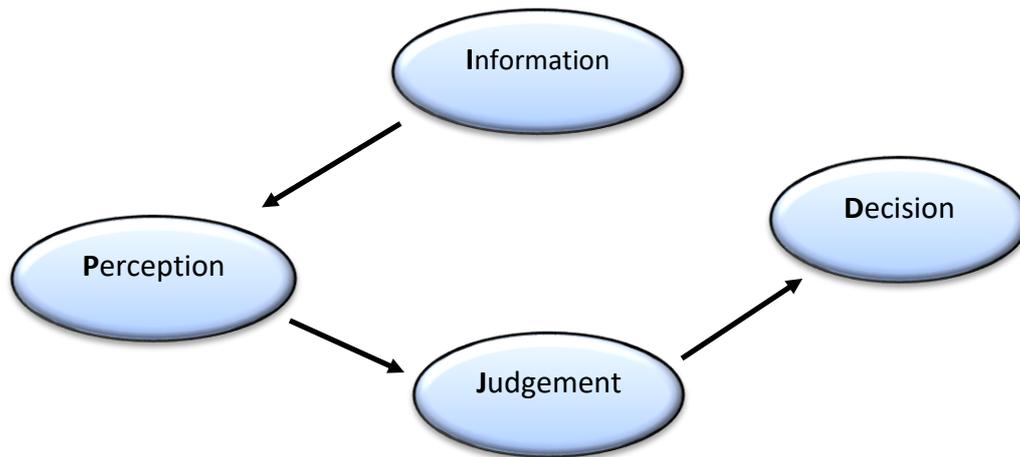


Figure 2.11 **I**→**P**→**J**→**D** “Process thinking begins with Information influencing Perception then effecting Judgment to Decision” Rodgers (2006, p.30).

2.10.3 Summary of Studies on EPTM

Table 2.1 presents a summary and review of various published studies that have dealt with EPTM. This information is presented to augment the theoretical element of this study.

Author(s) & Year	Research Issue	Research Method	Results / Findings
Rodgers et al. (2013)	Investigation of the association between innovation efforts, corporate social responsibility and financial performance.	Empirical analysis using quantitative method of Partial Least Squares (PLS)	There is a positive impact on a firm's financial performance if it has commitment towards corporate social responsibility (CSR), or socially responsible behaviour. It may particularly improve the extent of the firm's profitability after considering investing in advanced operations. Furthermore, customer loyalty (including general customer perceptions), as well as the perceptions of other stakeholders, may be improved by CSR, thus aiding the firm's financial performance.
Guiral et al. (2010)	Investigation of whether conflicts of interest will render auditors less likely to issue warnings to their clients.	Throughput Model	The results indicate that there is unintentional reluctance on the part of auditors to issue qualified audit opinions affecting the decisions of the investors, due to their feeling of aiding the ultimate bankruptcy of their clients.
Rodgers et al. (2015)	Study of the relationship between ethics, internal control and fraud.	Ethical Process Throughput Model, embedded in the Fraud Triangle	When the ethical behavioural control systems are applied appropriately, unparalleled security, increases convenience and accountability and better fraud protection can be ensured, which in turn can improve CSR within organisations.
Rodgers and Guiral (2009)	Investigation of the ways and extent/ time period of using the formative factors, along with reflective measures, to better represent complex theoretical constructs.	Literature review and Structural Equation Model (SEM)	The findings indicate that most of the previous studies modelled constructs that did not include formative indicators to represent the theoretical constructs.
Rodgers and Gago (2004)	Investigation of the impact of change in philosophies and individual ethical considerations on the reporting practices of companies	Resource dependence theory and a decision-making model – use of six pathways of ethical process thinking model.	The six philosophical theories have strong influence on the reporting practices of individuals and organisations.
Rodgers and Gago (2001)	Study of the impact of recent technological advances on financial reporting and the influence of ethical beliefs on individual decision-making	Throughput Modelling	A range of philosophical paradigms can be adopted to inform the way in which decisions are made. This study illuminates the foundational concepts that play a role in moral decision-making.

Rodgers and Gago (2006)	Study of the required modifications of decision-making models used by organisations. having stronger links with ethics and morality,	Throughput Model	The findings suggest a return to the base values of Christianity, where six dominant ethical approaches can be used to control the organisational practices.
Rodgers (2009)	Evaluation of the effect of changing environmental conditions, limited time, information asymmetry, and expertise on how the primary trust pathways of category-based trust, rule-based trust, and rational choice are applied.	Throughput model and six dominant pathways	The study suggests the integration of trust into a throughput model, which would facilitate the identification of dominant decision-making pathways and can also help in further analysis, to frame the problem in an expert way. Such integration might also help in determining which pathways would yield more useful outcomes.

Table 2.1 a review of EPTM studies (Source: Author)

2.11 SUMMARY

The purpose of this chapter has been to introduce, with regard to the scholarly literature, several definitions of corporate governance, to outline its significance, to explain who the beneficiaries of corporate governance practices are and to introduce several theoretical models. Corporate governance models were also examined in this section, including the continental European stakeholders' corporate governance model, as well as the Anglo-American shareholders' corporate governance model. Finally, corporate governance theories were subjected to an evaluation by examining agency theory, shareholder, theory, stakeholder theory and stewardship theory. Also included was a review of the ethical process thinking model (EPTM) as phases and pathways, and a summary of relevant studies.

Chapter 3

CONCEPTUAL FRAMEWORK AND DEVELOPMENT OF HYPOTHESES

3.1 INTRODUCTION

In this chapter, a conceptual framework is described, including the ETPM that was used in this research to capture the different pathways and stages that might influence the decision-making process in any organisation. The conceptual framework facilitates the sequencing of the arguments dealt with by this research. As suggested by Foss and Rodgers (2011), the framework incorporates the constructs of perception, information, judgment and decision choices as these constructs apply to different circumstances. The design of the conceptual framework and a discussion on each of the constructs form part of this chapter. This chapter includes a general description of the three pathways covered in the conceptual framework as they have been dealt with various previous research studies. The concepts of the expedient pathway, the ruling guide pathway and principle-based pathway, as they apply to the variables, are explained.

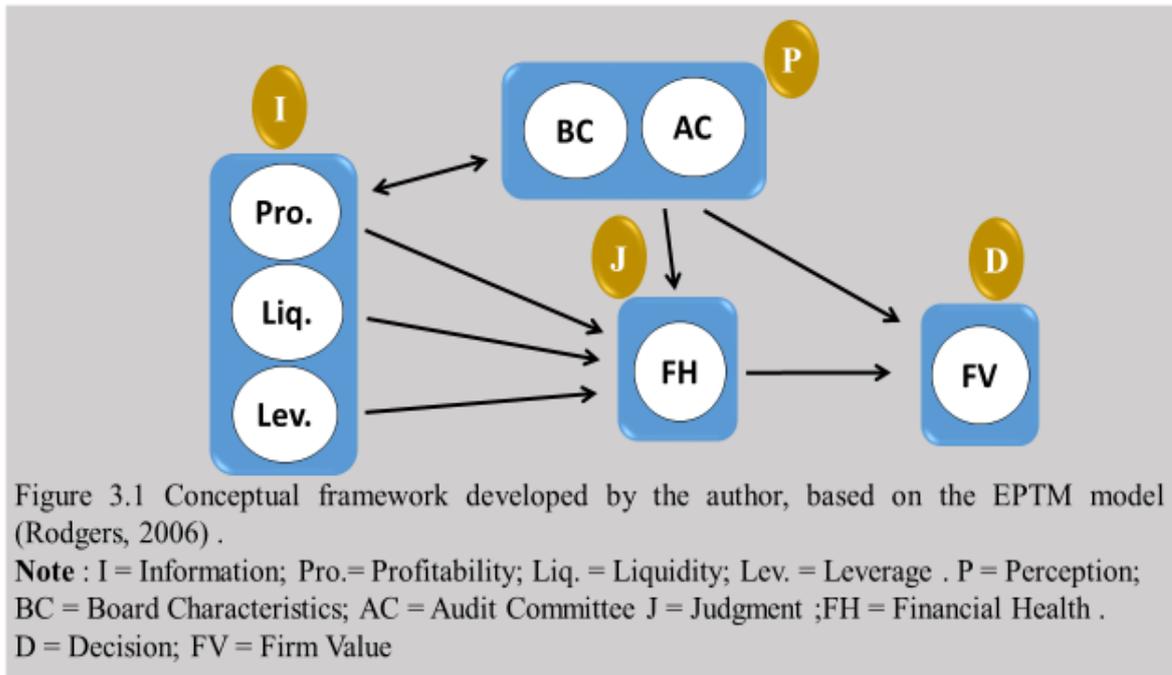
In addition, the development of hypotheses covering the variables of board characteristics, audit committee, profitability, liquidity, and leverage and their impact on financial health of the firm and firm value explained within this chapter. Since the variable of Tobin's Q can be considered as a comprehensive measure of the value of a firm, the relationships between profitability, liquidity and leverage with financial health are explained in detail. The reasoning for each hypothesis, as drawn from the literature, is also discussed, in order to provide theoretical understanding of the application of the ETPM to the research issue.

The theoretical concepts and methodology, as dealt with by the previous research studies in respect of the abovementioned variables that led to the development of the hypotheses, are summarised in this chapter. The research questions that were developed on the basis of the review of the previous literature are also included here.

3.2 CONCEPTUAL FRAMEWORK

One of the objectives of this research is to provide an understanding of the manner in which the current values and convictions of an individual are taken into account in their decision-making process. Taking an ethical decision requires the decision maker to take responsibility for considering the values and arriving at a judgment in situations which may not be the same as those he / she has faced before. An ethical decision differs from an 'ordinary' decision in that there is bound to be a difference in the degree of emphasis being placed by the decision maker on values, during the process of making a decision. Values, judgments and perceptions perform a critical function when individuals engage in ethical decision-making (Trevino, 1986, cited in Rodgers and Gago, 2001). On the basis of these foundational tenets, a central aspect of this study is the theoretical framework of EPTM, which allows us to outline the multiple phases that may be affected by the decision-maker's ethical reasoning.

The model is useful when considering the following concepts, along with the ways in which they are related to one another in the context of the decision-making process: firstly, perception; secondly, information; thirdly, judgment and finally, decision/choice. The EPTM assumes an interdependence between the elements of perception and information, as the way in which a decision maker perceives an issue is influenced by the information in his / her possession (Rodgers, 1999). This model becomes significant as it depicts different pathways and stages that have an influence over a decision. Although any basic information processing modelling can be performed using a serial processing approach, this research assumes parallel processing, where different pathways lead to a decision. Decision makers, through their understanding of the different pathways, can improve or modify their decisions. The conceptual framework is shown in Figure 3.1, below.



The model applied in this research starts with the way in which the individual considers and understands the perceived ethical dilemmas. In the EPTM, the intensity of an ethical issue is assumed to have a significant influence on both the judgment and decision choice. It is crucial to acknowledge that, when an individual holds certain ethical principles as significant, the likelihood that they engage in unethical behaviour is considerably less. Hence, the degree to which an ethical issue is intense is regarded as a determinant of the nature of the ethical decision-making process, and the EPTM considers this ‘perception’.

The process of decision making involves the identification and selection of different solutions available to achieve the desired result. Nutt (2001) explains that an individual could improve his decisions by establishing the direction of the decision making with a definite objective and by taking into account the social, economic and political forces that might present certain challenges in achieving the desired objectives. It is also true that the decision making relates to the future and hence if information is used for such decision making, the individual needs to base his decision on some model which can provide predictive support to such decision making. The information is also subject to the perception of the individual based on his own characteristics and the characteristics of the information as explained elsewhere in this text.

In the context of corporate governance, financial reports by corporations provide the basis for the decision making by the investors and lenders. The value of information contained in the financial reports is determined by the quality of the financial reporting. The decision maker being the investor will be influenced by the value of the information and the way in which such information is being perceived by him. It is essential the investor considers both financial and non-financial information contained in the financial reports before he arrives at his decision about investing. The usefulness of the information to the investor can be enhanced by the qualitative aspects of the financial reports. For example, information contained in the financial reports about board characteristics such as size, composition, number of independent directors and about the constitution and functioning of the audit committee will go a long way in guiding the investor being the decision maker. It is also important to consider the fact the information requirement of individual users may vary to a large extent. Relevance and predictive value of the information are a few of the specific qualities of information that will help the investor, who is the decision maker. In this context, it is relevant to discuss about information and the factors that determine whether such information turns out to be the perception of the individual decision maker.

“Perception is a process by which individuals organise and interpret their sensory impressions in order to give meaning to their environment,” (Robbins and Judge, 2014). The perception of an individual is often influenced by factors like the perceiver, target and the underlying situation. Therefore, when an individual assimilates some information, and makes an attempt to interpret the information he/she collects, that interpretation is subjected to be influenced by the personal characteristics of the individual receiving the information. The perception of an individual is most likely to be shaped by the attitudes, motives, interests, past encounters and anticipations of the individual. Perception may also be distorted by the characteristics of the information being collected. The attractiveness, acceptability and the tendency to group similar information may also tend to affect the characteristics of the information and hence the perception of an individual. In addition, the context in which the information is received could also divert the attention of the individual, which in turn may shape up his/her perception.

Similarly, the characteristics of any information that makes it stand out can increase the probability of it getting perceived differently by different individuals. The performance expectations of an individual based on the information he collects will make him validate his perception. The approach of an individual to analyse the information received will have a strong influence on the way in which the information is being perceived by him/her. An individual who follows a logical and rational approach is most likely to process the information serially and form his perception accordingly. On the other hand, an individual who is creative and intuitive tends to approach the information as a whole and hence his perception may differ (Robbins and Judge, 2014). The tolerance level for ambiguity of an individual will also determine the character of perception and the resultant decision making. While some individuals will expect to have minimal ambiguity, others may have the ability to process a bunch of information simultaneously. These qualities are likely to have a serious impact on the perception of the individuals.

Following the above discussion, the information on the facts about audit committee collected by individuals can be characterised as mere information or perception of the individual in possession of the information. Such characterisation depends mainly on the character of the information itself, personal characteristics of the individual, the attitudes, motives, interests and past experiences of the individual about the audit committee functioning in other contexts. An individual may attach importance to the facts about audit committee, only when he possesses knowledge on the extent to which the audit committee can act as a corporate governance tool. An individual who does not attach any importance to the audit committee is also likely to ignore the facts about the audit committee. In the case of board characteristics, the annual reports of corporations usually provide information on the composition and experience of their boards. Such information can be perceived by individuals who assimilate the information based on the context in which they have collected and used the information. In many instances, the interests and past experience of the individual determine whether the facts about the audit committee and board characteristics are information or perception.

From the corporate governance perspective, the factors of audit committee and board characteristics have been found to have a strong influence in determining the financial health, as well as the firm value, of a company. The audit committee is the initial determinant of corporate governance structure, in the present model. This research suggests that the degree to which an audit committee is effective is likely to have an impact on the nature of corporate governance within any given firm. Board characteristics constitute another variable, which also may determine the nature of corporate governance.

According to Ghofar and Islam (2015), the degree to which any given firm is performing effectively in a financial sense is significantly impacted by board characteristics, as indicated by profitability, liquidity, and leverage. Hence, the variables of board characteristics and the audit committee are included as perceptions in the EPTM applied in this research.

Perceptions regarding the way in which audit committees and boards function and are constituted are utilised in the context of the second stage of evaluation in this research. This second stage is chiefly concerned with the investigation of the financial health of a firm, along with its value. Information for the model is employed in the form of firm-related financial information, where the primary variables are profitability, liquidity and leverage. In the EPTM used for this study, the supposition is made that information combined with the perceptions (namely, audit committee and board characteristics) plays a role in determining the nature of the judgment of financial health. It is notable that the way in which a firm performs in the short term can be proxied by information relating to profitability, as well as other quantitative performance measurements. Nevertheless, it is equally pertinent to acknowledge that the way in which these performance measurements coincide with the long-term financial health of a firm is a similarly critical matter. Hence, this research's EPTM seeks to evaluate the degree to which audit committee effectiveness and board characteristics are statistically significant predictors of long-term financial health. A final noteworthy point in this regard is the fact that when these variables are considered in combination (i.e., profitability, liquidity, and leverage), it will be possible to gain comprehensive insight into any given firm's value.

A central supposition of the model is that perception (namely, audit committee and board characteristics) and information (namely, profitability, liquidity, and leverage) are interdependent. This implies that the information that individuals possess about the profitability, liquidity and leverage of a firm can influence the framing of their perception about the audit committee effectiveness and the board characteristics. Similarly, their framing of a problem can have an influence on the information they would like to use in their analysis of the alternatives. With a greater coherence between the perception and information, one can assume the reliability and relevance of the information set that is being used in the analysis. Because of the interdependence, information can also affect the perceptions that were established previously. As a case in point, when profitability is reduced, this could have an impact on the existing attitude of an individual regarding the degree to which the audit committee or board are effective and efficient. At the same time, the decisions a person makes, are likely to be affected by perception and judgment.

A number of previous research studies on corporate governance have focused on examining the accounting-based financial measures, such as profitability, in assessing the effectiveness of the governance measures. This model proposes to use ‘financial health’ as the summary measure of the accounting-based corporate governance effectiveness. One of the defining features of this construct is that it can take into consideration the effects that several accounting measures have on a firm’s value, including influences on profitability, liquidity, and leverage (Johnstone and Bedard, 2004). It is important that information on various dimensions of the financial health of a firm is collected and assessed because even if a firm is profitable, it may have cash flow issues that affect its ability to meet its short-term liabilities, and this issue may adversely affect the firm value. Similarly, a firm that is highly leveraged may find it difficult to resort to external funding. These issues are very likely to largely affect the financial health and value of a firm.

Based on the above model, a two-way relationship clearly exists between board characteristics and the audit committee, which underlines the interdependent nature of the two variables. This implies that, with an effective audit committee and efficient board, the short-term accounting performance can be improved and improvements in the short-term performance are likely to lead to the strengthening of the board and audit committees. This relationship is indicated by a two-way arrows in Figure 3.1. The two-

way arrows placed between perception and information pinpoint the weaknesses or biases in the judgments that follow a subjective course. This relationship, therefore, is subject to the cognitive shortcuts which may give rise to biases, which in turn characterises the reasoning process of an individual that connects the phases of perception and information. Such biases may develop because of the limitations in information processing ability, complexity of the information and lack of coherence (Kleindorfer et al. 1993).

The effects of the audit committee composition and board characteristics, as well as that of the short-term financial performance measures on the long-term financial health of the firm, are also assumed by this model. The relationship is indicated by the arrows placed suitably amongst the constructs in Figure 3.1. Perceptions on the part of the investor, about the effectiveness of audit committee and the efficiency of the board based on its characteristics, lead to the assessment of the financial health which ultimately provides a decision choice about the firm value. A thorough examination of the relationship between these constructs is the objective of the EPTM being used by this study.

3.3 RESEARCH FRAMEWORK AND HYPOTHESIS DEVELOPMENT

The over-arching aim of the study is to illuminate the effects that various determinants of corporate governance have on the value of various companies listed in the UK and the KSA stock exchanges. As was noted in the previous section, firm value in this context is proxied by the three quantitative measures of profitability, liquidity, and leverage. In addition, it should be noted that when attempting to achieve this aim by way of the EPTM, the expedient pathway, the ruling guide pathway and the analytical pathway are used.

In the context of the present research, the corporate governance determinants of audit committee and board characteristics are also taken into consideration. The impact of these determinants with profitability, liquidity and leverage on the variables like financial health and firm value and the inter-relationship amongst the variables, are examined by adopting the three pathways forming part of the conceptual model.

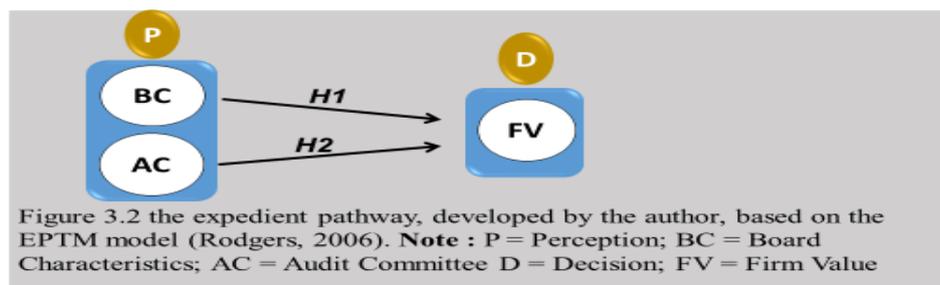
This research is based on the assumption that ethical behaviour is one of the important prerequisites for information exchange and problem framing. In this research, ethics is integrated into an ethical process thinking model (EPTM) in which the three dominant pathways are considered. The EPTM has the distinct advantage of identifying the dominant decision-making pathways in relation to the three primary levels of ethical considerations (Rodgers, 2009). The EPTM also helps in extending the analysis further to all available information, so that an individual can form his / her perception in a better way. These advantages have justified the use of the EPTM for this research.

Implementing an EPTM enables an individual to match the descriptive ethical pathway to his normative ethical way whilst attempting to resolve problems. Thus, the research design of EPTM combined with the conceptual framework will enhance the knowledge of the extent and type of ethical pathways that could influence the relationship of the determinants of corporate governance to the research variables of financial health and firm value. Gaining insight into this issue will be useful when attempting to identify the pathway that it is viable to use, to enhance the degree to which the various determinants of corporate governance are effective.

A detailed review of the relevant literature was undertaken as a part of this research, in order to develop relevant hypotheses and frame the research questions. The basis on which the hypotheses and research questions were framed is explained in the subsequent sections. In the context of the expedient pathway, the research evaluates the correlation between board characteristics and firm value, as well as the correlation between the audit committee and firm value. Hence, appropriate hypotheses and research questions are formed in relation to this area of inquiry. The second pathway ruling guide deals with board characteristics and its impact on financial health and firm value as well as audit committee and its impact on financial health and firm value. The previous studies reviewed for developing the hypotheses and the research questions are listed, showing the findings that led to the framing of the hypothesis. By way of the analytical pathway, this study seeks to gain insight into the correlation between profitability, liquidity, leverage, financial health and firm value. Such relationship was examined from the perspective of the, by developing suitable hypotheses and framing of the relevant research questions.

3.3.1 First Pathway; The Expedient Pathway (P → D)

As has been suggested by many philosophers, preferences, rules and principles are the cornerstones of our generally accepted ethical standards. The expedient pathway (P → D) is one of the three primary pathways that is undertaken by individuals in order to arrive at a decision. This pathway also forms an integral part of the EPTM adopted for this research. In the expedient pathway, an individual will consider his perceptions, rather than the rules, to make a decision/choice. An individual frames a problem in his / her bid to arrive at a decision or choice.



Under the EPTM, the action of framing of the problems is referred to as ‘perception’. Therefore, based on the recent study conducted by Rodgers et al. (2015), perception is defined as the process by which a person frames a problem set (or, alternatively, arrives at the worldview associated with the problem). This process of framing the problem involves using the expertise of the individual in making use of the pre-acquired knowledge, and the extent of the expertise used depends on the nature of the problem in question. The framing also influences and guides the direction of the individual’s search of the individual in terms of retaining or discarding the incoming information that may be useful in solving the problem or in making a decision. Therefore, the expertise of a person, and his ability to categorise information, constitute the perception.

The expedient pathway represents ‘ethical egoism’ and emphasises that an individual must take action that could serve his personal interest (Pojman, 2002 quoted in Rodgers and Gago, 2006). This pathway does not emphasise the use of information that could influence one’s position, and an individual using this pathway may not consider it necessary to undertake an in-depth analysis of the positions of other people in arriving at a decision choice. Therefore, it can be stated that $P \rightarrow D$ is the most direct pathway by which an individual may arrive at the desired decision, since this pathway discards any other relevant information that might alter the perspective of the individual and does not demand a particularly complex analysis before yielded a decision or choice.

There are three fundamental issues that might prevent an individual from appropriately tempering their attention the data sources and discarding some of the information that is otherwise available for consideration in the decision-making process. These are (i) incomplete information, (ii) lack of complete understanding and (iii) undifferentiated alternatives (Lipshitz and Strauss, 1997, quoted in Rodgers and Gago, 2001). Due to these three factors, the information available to the individual may be limited or unreliable in its contribution to an effective decision-making process. Lack of time to make a detailed analysis may also affect the ability to use all the available information. Figure 3.2 illustrates this on this pathway and includes perception which has incorporates two corporate governance (in this case, board characteristics and audit committee) that may be expected to influence the firm’s value at times of decision. These matters will be discussed in greater detail in the next section.

3.3.1.1 Board Characteristics (P) and Firm Value (D)

The initial corporate governance variable, as previously noted, is board characteristics, and this is regarded as the perception. Therefore, it is to be expected that certain aspects of the board of directors are statistically significant determinants of the corporate governance practices that are adopted to elevate firm value. The competitiveness and enhancement of the firm’s value depend largely on the ability of the board to provide guidance and direction to the company, which in turn depends on the characteristics of the board.

Several previous studies have examined the correlation between certain characteristics of a company's board of directors and the overall value of the firm. In the context of these studies, board characteristics are the number of non-executive directors, executive directors, board size and meeting directors. In the study conducted by Dehaene et al., (2001), return on equity (ROE) was identified as one accounting measure that was related in a significant and positive way with the number of independent directors on a firm's board. According to Johnson et al. (1996), appointing outsiders on the board will help the firm to gain access to critical resources. With a higher level of ROE, the firm's value can reasonably be expected to increase, hence the board characteristics are most likely to influence the firm's value. O'Connell and Cramer (2010) identified a consistent finding regarding the significant and positive correlation between firm value and board characteristics.

With respect to the tenets of agency theory, it is reasonable to expect that when a board contains many directors, the guidance of senior managerial personnel will be enhanced, owing to the diverse experience of the board. Ultimately, this is expected to translate into firm value. Notably, however, in the study conducted by Yermack (1996), a negative and significant relationship was observed between the number of directors on a firm's board and that firm's value.

According to stakeholder theory, it is of fundamental importance for firms to take into consideration the interests of every relevant stakeholder when making decisions. From this it can be inferred that the most effective board of directors is one which establishes equilibrium with regard to the interests of all stakeholder groups. The board needs to set the overall policy of the firm in such a way that the firm's value is enhanced through the protection of the interests of all stakeholders (Cornforth, 2004).

Drawing on the tenets of resource dependence theory, an important study conducted by Hillman and Dalziel (2003) indicated that board capital is a statistically significant predictor of firm value, in a positive way. The researchers suggested that this is due to the way in which board capital facilitates the provision of resources that the company needs, as well as appropriate monitoring practices. Here, it should be noted that resource dependence theory explicates the various ways in which firm operations are impacted by the availability of external resources (Pfeffer and Salancik, 1978). This theory also argues that it is important for an organisation to acquire resources for its survival.

Table 3.1 presents a summary of studies with their theories, methods and results.

No.	Author/s & Year	Research Issue	Theory	Method	Result/Finding
1	Dehaene et al. (2001)	Study of the impact of the board characteristic of board composition on firm value	Agency Theory	Empirical Tests	Board size as well as how many independent directors were on the board were observed to positively affect the value of the firm (in this case, ROE acts as proxy for firm value)
2	Yermack (1996)	Investigation of the correlation between board size and firm value	Stewardship Theory	Tobin's Q	Board size and firm value were found to be correlated negatively
3	O'Connell and Cramer (2010)	Evaluation of the relation between firm value, board composition, and board size	Agency Theory	Quantitative Empirical Tests – Linear Regression	Board size was found to be correlated with firm value in a negative way. In addition, non-executive director characteristics were positively correlated with firm value
4	Cornforth (2004)	Study of the impact of different theories on board effectiveness and firm value	Stakeholder Theory	Comparative Study based on different theoretical perspective	The purpose of the board is to establish equilibrium regarding the interests of various stakeholder groups, thereby facilitating positive firm value
5	Hillman and Dalziel (2003)	Evaluation of the effect of characteristics of the board on the value and performance of the firm	Resource Dependence Theory	Theoretical Review	Board characteristics affect both board monitoring and provide resources and hence increase the firm value.

The above discussion leads to the following research hypothesis and question:

RQ1: Do board characteristics significantly impact the firm value?

H1: Board characteristics have a positive impact on the firm value.

3.3.1.2 Audit Committee (P) and Firm Value (D)

The second variable of corporate governance is the audit committee, which is categorised as part of the perception phase; besides controlling the reliability of the accounting processes of a firm, the audit committee has the responsibility to ensure compliance with legal and ethical requirements. The audit committee is also entrusted with the function of introducing, implementing and/or monitoring fraud prevention mechanisms (Turley and Zaman, 2004 Findings indicate that when firm value is affected in a positive way by corporate governance, the determining variables include the audit committee and its features, the main features being size, number of meetings

in a given period, independence and expertise (Al-Matari et al., 2012; Reddy et al., 2010).

As was noted by Klein (2002), a considerable body of evidence has been accumulating that documents the correlation between various characteristics of a firm's audit committee and the firm's value. The research on the impact of the audit committee on firm value has produced results showing both negative and positive association of the audit committee with firm value. Several studies in the literature have sought to examine the relationship between shareholder wealth, firm value and various audit committee characteristics. The audit committee characteristics can also influence the reporting quality, and thereby alter the impression that investors have of the likely firm value in the future. As a case in point, evidence was reported in one study to suggest that audit committee characteristics were negatively correlated with firm value, the latter being proxied by return on sales, return on assets, net income, and asset turnover (Bozec, 2005). However, contrasting results were published in the later study, conducted by Reddy et al. (2010). In particular, Reddy et al, in a study based in New Zealand, found that certain characteristics of audit committees had a positive impact on firm value. In particular, the researchers' statistical analysis indicated that when audit committees meet more frequently, firm value is likely to increase, owing to the way in which this heightens the level of supervision the firm is subject to. Hsu and Petchsakulwong (2010), however, confirmed the opposite of this relationship when they analysed the correlation between audit committee meetings' frequency and firm value.

Another important point made in the literature is that the number of independent directors who sit on a firm's audit committee is a statistically significant determinant of firm value. In particular, Carcello and Neal (2003) and Dey (2008) have demonstrated that the degree to which an audit committee is independent, is related to the firm's value in a directly proportional way, and this stems from the way independence in this respect tends to correspond with effective monitoring of financial reporting. This argument is countered by the statement that a more independent audit committee may not be able to identify the industry issues which may negatively the extent of monitoring, and thus limit or restrict the enhancement of firm value. Greater levels of independence and expertise on audit committees can contribute to higher levels of firm value as reported by Chan and Li (2008).

Table 3.2 presents a summary of studies with their theories, methods and results.

No.	Author/s & Year	Research Issue	Theory	Method	Result/Finding
1	Bozec (2005)	Examination of the impact of audit committee size on firm value	Agency Theory	Multiple Regressions	Audit committee size was found to be negatively related to firm value (proxied by return on sales, return on assets, and assets turnover)
2	Reddy et al. (2010)	Examining the effect of size of the audit committee on the value of firms in New Zealand	Stakeholder Theory	Regression of Two Step Least Squares and Ordinary Least Squares	The findings indicate positive association between audit committee size and firm value
3	Al-Matari et al. (2012)	Impact of audit committee size on firm value	Agency Theory	Multiple Regression	A positive relationship between the value of the firm (which was proxied by return on assets) and the size of audit committee was determined
4	Khanchel (2007)	Evaluation of the link between value of the firm and number of audit committee meetings	Shareholder Theory	Multiple Regression Model	A positive relationship between the number of audit committee meetings and firm value (proxied by Tobin's Q) was observed
5	Chan and Li (2008)	Evaluating the link between the value of the firm and audit committee independence	Resource Dependence Theory	Multiple Regression	A positive relationship between the value of the firm and the presence of independent and expert directors on the audit committee was observed

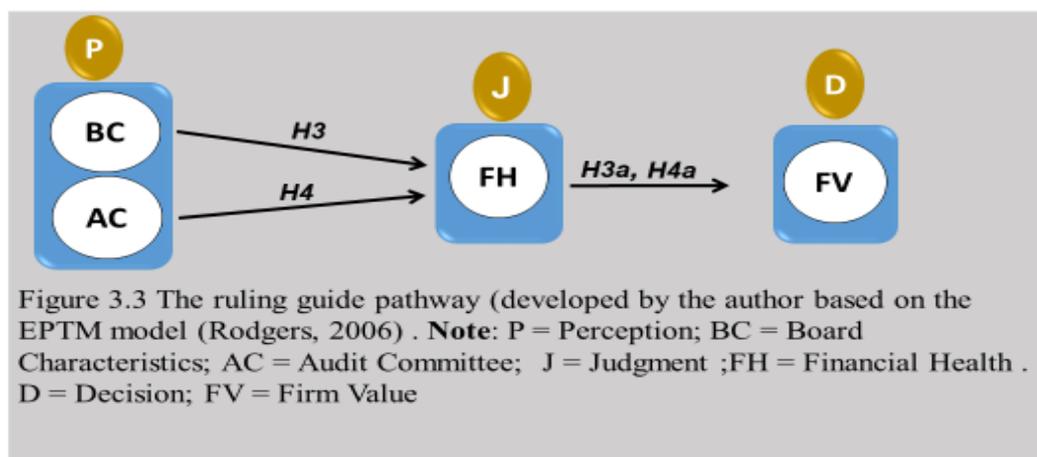
The above review leads to the following research question and hypothesis:

RQ2: Do audit committees significantly impact the firm value?

H2: The audit committee has a positive impact on the firm value.

3.3.2 Second Pathway, The Ruling Guide Pathway (P → J → D)

In accordance with deontology, the ruling guide pathway (P → J → D) places a focus on individual rights, as well as the judgments which relate to any given decision-making process. Figure 3.3, below, depicts the relationships that exist among the three elements of perception, judgment and decision choice. While using the ruling guide pathway, the decision-making becomes judgment oriented, and is subject to the perceptions of an individual concerning the rules and laws in force. As a result, according to Rodger and Gago (2004), the decision is informed by a judgment, which is in turn promoted by the perception an individual has about some phenomenon or phenomena. In the ruling guide pathway, the decision maker is not influenced by the information directly available, rather, that decision maker tries to take a decision by reaching the judgment stage directly from the problem framing stage.



The decision maker may be justified in ignoring the information content for at least two objective reasons, namely that the information may turn out to be either unreliable or inadequate (Rodgers, 2009). When the ruling guide pathway is being followed, the emphasis is on the rules or norms established to meet particular requirements in given situations. Rules, when accepted as reasonable and widely followed, are most likely to provide guidance for the people to behave in particular ways during the decision-making process. Such rules may also incentivise people to behave in expected/predictable ways within a decision-making situation. However, the levels of trust among people are expected to decrease, where the ruling guide situations are prevalent. As noted by Dirks and Ferrin (2001), favourable outcomes are more likely where trust and minimal regulation are present.

One of the basic elements of the ruling guide pathway is that in this pathway, trust has an association with social structures, and the intensity of the association depends on factors that are individual- or institution-specific. As a consequence of this, the perceptions a person holds (or, alternatively, the problem they frame) is the determinant of the selection of information to be applied in the judgment. This pathway provides the opportunity, for an individual who is morally bounded and has appropriate motivation, to take decisions based on their understanding of the appropriate task to be performed. On the other hand, a morally lacking individual may not have the opportunity to acquire such understanding. When operating within a normative rule or legal system that is strictly enforceable, an individual can trust others and this generates and underpins the ruling guide trust (Lewicki et al. 1998). In such situations, it is unlikely that rules and norms will be changed suddenly, or that such rules and norms become mental representations of internalised knowledge. It is possible for regulations and conventions of this kind to offer direction, or motivating factors, for use by those wishing to make certain decisions. In the event that regulations are implemented in a standardised way, trust can emerge, and consequently, collaborative activities are likely to take place on the basis of mutual trust (Pearce et al., 2000).

Ultimately, the question of whether these laws are official or unofficial is unimportant; rather, given the judgmental qualities of some values, trust-related matters can sometimes not be incorporated into regulations. On this pathway, as illustrated in Figure 3.3, that includes perception which has two factors of corporate governance (here, board characteristics and the audit committee) that may have an impact on financial health and consequently on firm value.

3.3.2.1 Board Characteristics (P) Financial Health (J) and Firm Value (D)

It is often assumed that if a board of directors has a significant number of members from outside the organisation that it will make different decisions to boards with most members from inside the organisation, and that those decisions may lead to better results. In addition, according to Fama and Jensen (1983) non-executive directors are important when it comes to resolving agency problems effectively, and having non-executive directors aids decision making; however, studies in this area have produced a range of results. Studies carried have revealed that non-executive directors often monitor managers effectively and protect the interests of shareholders, which leads to improved financial performance, stock returns and credit ratings.

Dehaene et al.'s (2001) study determined that there is a positive correlation between the percentage of outside directors and the financial performance of firms. Moreover, a study by Connelly and Limpaphayom (2004) ascertained that a board's composition negatively affects risk-taking behaviour and positively affects profitability. A positive stock price reaction was noted to occur as a result of the appointment of an extra outside director by Rosenstein and Wyatt (1990), which suggests that the percentage of outside directors will have an impact on shareholders' wealth. Several researchers, such as Bhojraj and Sengupta (2003) and Ashbaugh-Skaife et al. (2006), determined higher bond as well as credit ratings among firms with boards having a larger number of independent outside directors. Further, as stated by O'Sullivan (2000), because of their role in monitoring, intensive audits are favoured by non-executive directors, generally resulting in reduced agency costs.

Past research has provided evidence that the board characteristic of the number of independent directors appears to affect the firm's value and financial health to a great extent. One study, which analysed a sample of listed companies in Europe and the United States, noted that variance in the number of independent directors on a board was correlated with firm value (Hirschey et al., 2009). However, that study has not provided any convincing evidence that this board characteristic correlates with higher profitability of the firms or faster growth in financial health of companies in these jurisdictions. It also found that some firms having a majority of independent (non-executive) directors were less profitable than other firms that were studied. Studies in the literature have found that the board characteristics of knowledge, skills and attitudes, and the ability of the board members to apply them diligently, also are likely to affect the performance of a firm in terms of its financial health and firm value. According to Cicero et al. (2013), the greater the ability of the board to provide these qualities, the more it is likely to provide a strategic direction to the firm and this will enable the firm to reach its financial objectives more efficiently. This finding is consistent with Colley et al. (2003), who noted that the degree to which a board holds expertise is a positive and statistically significant predictor of a firm's financial health.

In the structure of a board, corporate financial performance as well as the size of the board size is vital. On the one hand, large boards may ensure diversity, which could assist companies in securing critical resources, as well as reducing environmental uncertainties (Pfeffer, 1987; Pearce and Zahra, 1992; Goodstein et al., 1994). On the other hand, Yermack (1996) describes how a large board can result in poor coordination and communication, and problems with decision-making, leading to a negative impact on the company's financial performance. Therefore, there is a trade-off when adding a new member to the board between diversity and coordination. Jensen (1993), along with Lipton and Lorsch (1992), recommend seven or eight board members, but as Adams and Mehran (2003) point out, optimum board size depends on the particular industry, for example bank holding companies usually have a significantly larger size board than manufacturing firms .

Board size is often reported as a statistically significant determinant of firm value, the main reason being given that a large board has access to a wider range of information and expertise than its smaller counterparts. Board size is positively linked to company financial performance according to Dehaene et al. (2001), but Haniffa et al. (2006) did not find definite evidence for this in their market return measure of performance; in fact, they discovered that large board are often less effective at monitoring performance, although on the positive side, they found that large boards often lead to more diverse contacts, and greater experience and expertise, which enhances performance. Yermack's (1996) study determined that value of the firm and the size of the board had an inverse correlation and that, with increase in board size, financial ratios concerning operating efficiency and profitability decreased. Connelly and Limpaphayom (2004), however, did not find any link between board size and firm financial performance.

Raheja (2005), reported that no statistically significant correlation was observed between the variable of a firm's financial performance and any dependent variables related to board characteristics. In contrast, in the earlier study conducted by Lehn et al. (2003), it was noted that boards provide firms with vital information that they need to perform effectively in any given industry. Furthermore, studies such as the recent research conducted by Kumar and Singh (2013) indicate that overly-large boards can negatively affect financial health and firm value. Although the board characteristic of board size is dependent on the size of the firm, large boards have been found to be less efficient in contributing to the financial health of the firms, owing to the difficulties involved in providing solutions to the agency problems arising among board members. In contrast to Kumar and Singh's (2013) research, an earlier study by Belkhir (2009) indicated that board size was a positive statistically significant predictor of a firm's financial health.

It is possible to measure the board meetings' effect on firm performance based on the frequency of meetings. Moreover, as stated by Vafeas (1999), despite the lack of clear evidence regarding the relation between board meetings and firm performance, board meetings are crucial to boards. Furthermore, there are costs associated with board meetings, including directors' remuneration; travel expenses, and taking up managerial time, and so if a company is underperforming, it may be more beneficial to reduce the number of board meetings in order to avoid these costs. According to Jensen (1993), it is important that meetings involve significant dialogue among directors. Moreover, if a

firm is performing badly, more meetings may be necessary in order to address the problems and implement strategies for improvement. Lipton and Lorsch (1992) note the importance of regular meetings to monitor issues of concern and check up on management practices to ensure that everyone is performing their duties effectively. Good coordination is required for this, and if board meetings are organised in a timely fashion, it should lead to better efficiency and reduced agency costs.

No.	Author/s and Year	Research Issue	Theory	Method	Result/Finding
1	Raheja (2005)	Evaluating the link between value of the firm and characteristics of the board	Resource Dependence Theory	Generalised method of moments regression model	No correlation was determined between value of the firm (Tobin's Q acted as proxy) and board characteristics
2	Belkhir (2009)	Evaluating the link between banking firms' financial performance and board size	Agency Theory	Panel univariate analysis and panel data techniques	A positive correlation was noted between performance of the firm (Tobin's Q and return on assets acted as proxy) and size of the board
3	Kumar and Singh (2013)	Analysis of the impact that board characteristics have on firm value	Stakeholder Theory	Linear Regression Models	A negative correlation was observed between board size and firm value .
4	Lehn et al. (2004)	Evaluating the impact of size of the board and its composition on value of the firm	Agency theory	Regression Models	No relationship was noted between board size or board composition and value and performance of the firm
5	Cicero et al. (2013)	Study on the change of board structures	Stewardship Theory	Statistical analysis of panel data	A positive correlation was observed between performance of the firm and composition of the board

Table 3.3 presents a summary of relevant studies with their theories, methods and results

From the above discussion, the following research questions and hypotheses follow:

RQ3: Do board characteristics significantly impact the financial health of firms?

RQ3a: Do board characteristics significantly impact firm value through the firm's financial health?

H3: Board characteristics have a positive impact on the financial health of firms.

H3a: Board characteristics have a positive impact on firm value through the financial health of the firm.

3.3.2.2 Audit Committee (P) Financial Health (J) and Firm Value (D)

According to Carcello et al. (2003), studies of corporate governance frequently underline the statistically significant impact that the characteristics of audit committees, ranging from composition to expertise, have on firm value and financial health. Although consensus has not yet been established regarding the precise nature of the impact of these characteristics on the variables of firm value and financial health, compelling evidence has been published to suggest that firm value is positively affected in those instances where the audit committee holds a high degree of expertise (Chan and Li, 2008).

Furthermore, the literature has established, to a considerable level of certainty, that various characteristics of the audit committee, if they promote the development of more effective supervisory mechanisms with respect to financial reporting and internal control systems, have a consistent and positive impact on a firm's financial health (Anderson et al., 2004). Empirical evidence shows that firms having an effective audit committee are likely to incur lower costs relating to debt and this contributes to increased financial health (Anderson et al. 2004). The presence of professionally experienced members in the audit committee contributes significantly to more effective monitoring of the operations of the firm, and hence to increased financial health and firm value (Raghunandan and Rama, 2007). The findings of the past research evidence positive reactions of the market to the appointment of new members to the audit committee, which is likely to result in higher firm value. However, Vafeas (2005) found a negative effect of the audit committee on financial health, since 76% of the members of the audit committees studied lacked sufficient auditing experience to monitor the financial affairs of the firms.

The existence of an audit committee is important for the maintenance of transparency in firms. Given that the members of the audit committee are simultaneously members of the board of directors, it is their responsibility to establish and apply the strategic approaches that can promote firm financial health. Therefore, when the audit committee presents a true picture of the financial status of the firm to the other board members and shareholders, the board will be able to implement suitable strategies that will help in improving the financial performance and hence the firm value (Bhardwaj and Rao, 2015). Firm value is likely to increase as the reliability of the firm's financial statements improves, and an effective audit committee can ensure increased reliability by monitoring any manipulative activities on the part of managers. The presence of an independent audit committee will help to limit and control earnings management practices and hence will increase the financial health of a firm and firm value (Bouaziz and Triki, 2012).

When audit committees convene on a frequent basis, the agency problem is mitigated against, and it is also the case that information asymmetry can be reduced. Hence, it becomes possible for shareholders to gain access to accurate information at the right time, thereby promoting firm value (Saleh et al., 2007). With a greater number of audit committee meetings, the quality and level of investor protection will be substantially increased, increasing the firm value.

Table 3.4 presents a summary of relevant studies with their theories, methods and results.

No.	Author/s & Year	Research Issue	Theory	Method	Result/Finding
1	Chan and Li (2008)	Relationship between audit committee independence and firm value	Resource Dependence Theory	Regression Models	The audit committee independence contributes to enhanced firm value
2	Anderson et al. (2004)	Board characteristics, audit committee presence and cost of debt	Resource Dependence Theory	Regression Models	Fully independent audit committees are likely to contribute to lower cost of debts and increase profitability
3	Raghunandan and Rama (2007)	Investigation of factors determining the diligence of audit committees	Stewardship Theory	Ordinary Least Squares regression	Increased presence of professional members in the audit committee contributes to increased financial performance of firms

4	Bhardwaj and Rao (2015)	Examination of the role and responsibilities of audit committees	Agency Theory	Statistical analysis	Presence of audit committees increase transparency among the firms and increase the firm value
5	Bouaziz and Triki (2012)	Board independence and firm profitability	Shareholder Theory	Regression Analyses	Audit committees help in curtailing the earning management practices of managers and thus helps in increasing the firm value in the long run

The review of the literature as discussed above leads to the following research questions and hypotheses for testing:

RQ4: Does the audit committee significantly impact the financial health of a firm?

RQ4a: Does the audit committee significantly impact the firm's value through its financial health?

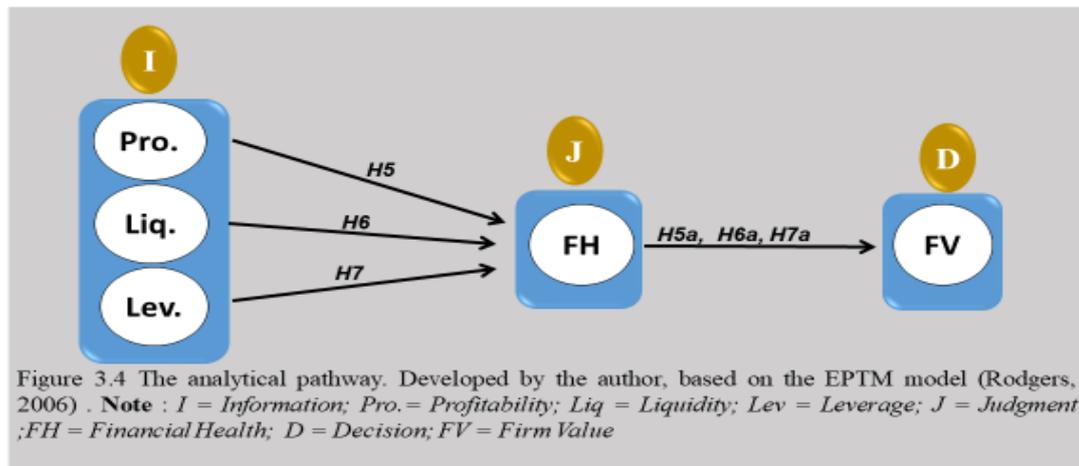
H4: The audit committee has a positive impact on the firm's financial health.

H4a: The audit committee has a positive impact on firm value through the financial health of the firm.

3.3.3 Third Pathway: The Analytical Pathway (I → J → D)

The analytical pathway implies that the correct ethical action of an individual is determined by the outcomes of the intended action. The principles underlying the decision-making process incorporate the values, attitudes and beliefs of the individual concerned. These values, attitudes and beliefs normally relate to the actions an individual proposes to take, taking into account the ethical issues involved in the problem on hand. These principles are considered as the foundation to any series of cognitive processes that is connected with the decision-making process (Rodgers, 2009). These values and beliefs are also expected to be the motivators that influence the judgments of individuals involved in the decision-making and the values and beliefs help in structuring the important information required for judgments before decisions are made in an ethical manner. Thus, the analytical pathway requires the availability of reliable and relevant information so that the individual is guided through the ethical considerations (Rodgers, 2009).

Utilitarianism constitutes the foundation of the analytical pathway, where conformance to the hedonic precept is the prime concern, i.e. the maximisation of the greatest level of happiness for the greatest number of individuals. Furthermore, as stated by Rodgers and Gago (2006), the analytical pathway is characterised by the timely analysis of relevant, typical, or agreed-upon information prior to the implementation of any decision.



The analytical pathway can be considered as similar to ethical egoism, where the main concern is that of consequences and to ensure that the greatest good happening to great number of people. In addition to maximisation of good, this pathway is committed to the minimisation of harm. This pathway suggests that the society should always strive to produce the maximum balance of positive value to all the people affected (Rodgers and Gago, 2006). Rodgers (2009) refers the analytical pathway as category-based trust, where he claims that direct information directly impacts the decision choice through judgment. Rodgers (2009) also suggests that the individuals, while framing the information, are influenced by pre-formatted information that is concerned with relationship types. The category-based trust is based on the norms relating to obligation and co-operation developed using the shared information. Figure 3.4, above, illustrates how this pathway includes information which comprises three factors, in this case profitability, liquidity and leverage, that may have an impact on financial health, which may in turn affect the firm's value. This will be explored further in the next section.

3.3.3.1 Profitability (I) Financial Health (J) and Firm Value (D)

Increased profitability indicates the growing financial performance of a firm, which in turn will help in increasing the firm's value (Damodaran, 2011). Managers are motivated to disclose more detailed information of a firm in order to support the continuance of their positions and remuneration and to signal institutional confidence. Samir, M. et al. (2003) as cited in Rouf (2011) argue that "higher profitability motivates management to provide greater information because it increases investors' confidence, which in turn, increases management compensation".

The relationship between profitability and firm value has been studied in just a limited number of studies. As a case in point, Haugen and Baker (1996) examined that impact that profitability has on firm value, and they noted a positive and statistically significant correlation. This finding was later supported by the study conducted by Yang et al. (2010). According to Yang et al. (2010), with greater profitability, firms will be able to generate more distributable earnings and thus enhance the firm's value in the long run.

A significant effect of the ratio of profitability on the financial health has been indicated by Mahdaleta et al. (2016) using the capital structure theory. According to Myers (1984), the capital structure theory incorporates an implicit assumption that firms are provided with numerous options when it comes to accessing broad and efficient capital markets, and they can meet their capital needs through modern financial institutions and thus control the cost of capital to enhance their profitability. With a higher profitability ratio, firms can substantiate their better financial performance, which is very likely to increase the firm's value. Similar findings of the impact of profitability on firm value have been reported by Bermig and Frick (2010).

Profitability also influences the financial health of the firms in the long run, and this is because, with increased profitability, firms will be able to increase their asset base by ploughing the retained earnings back into the company. The financial health of a firm will be reflected in its stock price, as the investments made in a firm's stock provide a positive signal about the good financial performance of the firm (Hasnawati, 2005).

In financially successful firms, profitability is used as one of the main sources of capital in order to maintain long-term financial viability and financial health. This is because higher profitability enables firms to avoid reliance on external debt to fund business growth. Excessive reliance on such external funding will add the cost of interest to the costs of the firm and thus might affect its profitability, which in turn will have its own impact on the company's financial health (Chen and Chen, 2011). Chen and Chen (2011) have used the pecking order theory to explain this situation. According to the pecking order theory, it is typically the case that firms will prioritise the use of internal rather than external sources, thereby limiting capital costs and heightening the degree to which they are profitable (Myers, 1984).

Here, it is important to recognise that financial performance is one of the proxies adopted to ascertain the overall financial health of an organisation, and since financial performance is strongly impacted by the firm's profitability, profitability has a high likelihood of impacting a firm's financial health in a significant way.

No.	Author/s & Year	Research Issue	Theory	Method	Result/Finding
1	Yang et al. (2010)	Study of impact of capital structure on firm profitability and value	Agency Theory	Multiple Indicators and Multiple Causes model	Profitability has a significant influence on the firm value.
2	Chen and Chen (2011)	Investigation of the influence of profitability on firm value	Pecking order Theory	Regression model	The more profitability, the greater will be the firm value.
3	Bermig and Frick (2010)	Impact of profitability firm financial performance of firms	Stakeholder Theory	OLS Regression	Higher profitability ratio enhances financial performance of firms
4	Mahdaleta et al. (2016)	Study of the influence of capital structure and profitability on corporate value	Theory of Capital Structure	Multiple Linear Regression Tests	Profitability is a statistically significant determinant of firm value

Table 3.5 presents a summary of relevant studies, with their theories, methods and results.

Having reviewed the literature on the relationship between profitability and financial health and the determinants thereof, the following research questions and hypotheses are developed for testing by this research:

RQ5: Does profitability significantly impact the financial health of a firm?

RQ5a: Does profitability significantly impact the firm's value through its financial health?

H5: Profitability has a positive impact on the financial health of a firm.

H5a: Profitability has a positive impact on firm value through the financial health of that firm.

3.3.3.2 Liquidity, (I) Financial Health (J) and Firm Value (D)

When a firm's liquidity is managed in a manner characterised by efficiency, evidence suggests that firm value will be positively affected. Hence, according to Singh and Pandey (2008), the appropriate management of liquidity is a crucial, financial, aspect of the firm's overall operations. According to Deloof (2003), an optimal level of liquidity will contribute to achieving enhanced firm value. According to the research conducted by Al-Mwalla (2012), a liquidity policy built upon conservative precepts is correlated with firm value in a positive way. Furthermore, Raheman and Nasr (2007) examined the effect that various components of liquidity (including average debtor collection period, cash conversion cycle and inventory turnover ratio) have on a firm's financial health, reporting that the various components of working capital management and firm financial performance are correlated in a statistically significant and negative way. However, these results were inconsistent with the earlier study conducted by Lazaridis and Tryfonidis (2006), who found that liquidity and the financial performance of a firm were correlated in a positive way, a conclusion which led the latter researchers to suggest that the appropriate management of liquidity (in particular, through cash conversion cycles) is likely to have a positive impact on the firm's financial performance.

In the KSA-based study conducted by Eljelly (2004), liquidity, proxied using the current ratio, was examined with respect to its correlation with firms' financial performance. Notably, the two variables were found to be correlated in a negative way. Another notable finding in that research was that, when firms are characterised by elevated current ratios and prolonged cash conversion cycles, the relationship displayed a higher level of statistical significance.

The results published by Nazir and Afza (2009) supported the existence of a negative correlation between liberal liquidity policies and financial health (the latter variable proxied by profitability). The study found that those firms that adopted stricter working capital management policies to control their liquidity, earned a lower rate of return, compared to the firms which followed conservative policies. In the Vietnam-based research conducted by Dong and Su (2010), a negative correlation was observed between liquidity and financial performance. The study reported that, while an increase in cash conversion cycle negatively affects the financial performance through a reduction in the inventory cycle, an increase in the debtors' collection period contributes to enhanced financial performance of the firm, increasing the financial health of the firms.

Table 3.6 presents a summary of studies with their theories, methods and results.

No.	Author/s & Year	Research Issue	Theory	Method	Result/Finding
1	Singh and Pandey (2008)	Analysis of the effect of working capital management on firms' financial health	Stewardship Theory	Multiple Regression	Maintaining liquidity through effective working capital management positively influences the financial health of firms.
2	Deloof (2003)	Analysis of the effect of working capital management on firm value	Theory of Capital Structure	Pearson's correlation, and regression analysis	A significant and positive correlation was observed between working capital management and the optimisation of firm value
3	Lazaridis and Tryfonidis (2006)	Investigation of corporate financial performance and working capital management	Stewardship Theory	Regression Models	Financial performance of firms can be improved by managers' handling cash conversion cycles effectively
4	Nazir and Afza (2009)	Impact of managing short-term assets and liabilities on the financial health of firms	Stakeholder Theory	Regression Analyses	Management of short term working capital positively influences the profitability of firms
5	Dong and Su (2010)	Impact of working capital management on financial performance and liquidity of firms	Agency Theory	Regression Analyses	Strong negative relationship between cash conversion cycles and financial performance of firms was found

For examining the relationship between liquidity, financial health and firm value, the following research questions and hypotheses are framed, based on the above discussions:

RQ6: Does liquidity significantly impact the financial health of a firm?

RQ6a: Does liquidity significantly impact firm value, through the financial health of a firm?

H6: Liquidity has a positive impact on the financial health of a firm.

H6a: Liquidity has a positive impact on firm value, through the financial health of a firm.

3.3.3.3 Leverage (I) Financial Health (J) and Firm Value (D)

Relatively few research projects have focused on the connection between leverage and firm value, with particular regard to the effect of the firm's capital structure. The literature is ripe with debates on the impact of the optimal capital structure of firms on the firm value. Based on the findings of Pandey (2004), it is necessary to take into consideration the debt to equity ratio, from the perspective of the effect this has on firm value. However, Gemmille (2001) is of the opinion that the leverage ratio of the firm affects the firm value only under certain conditions, and that the firm value is likely to be enhanced directly by the influence of the mixture of debt and equity. When the firms do not adopt a suitable leverage of their capital structure, they are likely to suffer from increased funding costs, which in turn will affect the firm value (Kochhar, 1997).

Limited studies have reported no relationship between leverage and firm financial health. In the study conducted by Ruland and Zhou (2005), the researchers examined the effect that leverage has on firm value (proxied by profitability), finding that the two variables were related in a positive and statistically significant way. This finding has been supported by the work of Robb and Robinson (2009).

According to Robb and Robinson (2009), firms gain significantly from leveraging, and the use of higher debt contributes to higher firm value. One of the arguments in favour of leveraging is that higher level of financial leverage enhances the return on equity, provided that the assets of the firm yield earning power greater than the average cost of debts incurred by the firm. It is possible for debt to be related to firm value in both a positive and a negative way (Aggarwal and Kyaw, 2006), meaning that the magnitude

of a firm's debt should be evaluated with respect to the costs incurred to service the debt, and the investment issues created by the presence of the debt. In the Egypt-based study conducted by Ebaid (2009), the researcher reported a negligible effect of leverage on firm financial performance, and the Tehran-based research of Pouraghajan and Malekian (2012) demonstrated similar results (in particular, examining the debt ratio and firm's financial performance). In a Vietnam-based study, researchers found consistent results (Quang and Xin, 2014). In contrast, however, Abor (2005) reported a significant and positive correlation between the total debt, total assets, and financial performance of firms (the latter proxied by return on equity).

Table 3.7 shows and describes a selection of relevant studies.

No.	Author/s & Year	Research Issue	Theory	Method	Result/Finding
1	Ruland and Zhou (2005)	Association between financial leverage and firm value	Agency Theory	Regression	Financial leverage enhances firm value
2	Robb and Robinson (2009)	Capital structure decisions of firms, and profitability	Pecking Order Theory	Statistical Tests	Greater reliance on external funding enhances firm value
3	Ebaid (2009)	Analysis of the effect of capital structure on firms' financial performance	Theory of Capital Structure	Multiple Regression Analysis	A negligible impact of capital structure decision on firm financial performance was observed
4	Pouraghajan and Malekian (2012)	Analysis of the effect of capital structure on firms' financial performance in the Tehran Stock Exchange	Theory of Capital Structure	Empirical Analyses	Debt ratio and firm financial performance were found to be correlated in a significant and negative way
5	Quang and Xin (2014)	Analysis of the effect of capital structure on firm financial performance in Vietnam	Stewardship Theory	Regression Models	A negative correlation was observed between capital structure and financial performance (proxied by ROA and ROE)

In order to study the impact of leverage on the profitability, financial health and firm value the following research questions and hypotheses are developed for this research:

RQ7: Does leverage significantly affect a firm's financial health?

RQ7a: Does leverage significantly impact firm value through the financial health of a firm?

H7: Leverage has a positive impact on the financial health of firms.

H7a: Leverage has a positive impact on firm value through the financial health of the firm.

The findings from the use of EPTM are expected to provide evidence accepting/rejecting the hypotheses developed for this study and thus answer the research questions framed in this chapter. The corporate governance norms as they were studied in the previous research provide an understanding that the board characteristics including size, composition, presence of independent directors and the formation of audit committees will help in enhancing the firm value and financial health and also the variable of liquidity, leverage and profitability will work positively to improve the financial health of the companies. However, most of the previous studies were undertaken in the context of developed countries where the legal foundation and institutional structures are conducive for better corporate governance compliance. Since this study is a comparative evaluation of the impact of corporate governance practices on the firm value and financial health of companies in a developed country (United Kingdom) and a developing economy (Saudi Arabia), it was thought to be wise to take a neutral stand on the outcomes of the research with respect to the impact of the corporate governance practices in Saudi Arabia. In the context of the United Kingdom, where the corporate governance norms and standards have been established and are in practice for a longer period supported by sound institutional and legal structures, both the variables of board characteristics and audit committees can be expected to positively and significantly impact the firm value and financial health of UK corporations. Similarly, the variables of profitability, liquidity and leverage can be expected to positively impact the financial health of the UK companies, because of the presence of many banks and financial institutions having a tight control over the financial performance of the firms. Moreover, the reporting requirements on the board of

directors have been made stringent providing for transparency and accuracy in the financial reporting.

Being a developing economy with a growing Capital market and developing legal systems, it can be expected that the board characteristics might positively impact the firm value and financial health of companies in the KSA. However, the impact of the presence and functioning of audit committees can be expected to present mixed evidence with respect to its impact on the firm value and financial health. It may be safely assumed that in the context of Saudi Arabia, the impact of profitability of the companies on the financial health might be positive as there are increased regulations imposed by the CMA for transparent financial reporting by the listed companies. The board of directors are also made responsible for proper and transparent reporting of the financial statements. Therefore, in order to ensure that the shareholders get a fair return on their investments, the boards of Saudi companies can be expected to act with financial prudence resulting in increased profitability of the companies. Nevertheless, with respect to the variables of liquidity and leverage, the assumption could be that the evidence would provide a neutral to negative evidence about the impact of these variables on the financial health of the Saudi firms.

3.4 REASONS FOR SELECTING THE THREE PATHWAYS

This section provides the justification for the selection of the three different pathways used in this research.

3.4.1 First Pathway: The Expedient Pathway (P – > D)

- It is the most direct pathway to arrive at a decision as it discards other relevant information.
- This pathway does not demand a more thoughtful analysis of information before arriving at a decision. Any decision by investors concerning the effectiveness of corporate governance might follow this pathway, and hence it is suitable for this research.
- The risks of incomplete information and a lack of complete understanding of the information must be recognised when considering the ability of individuals

to evaluate the ethics behind corporate governance. Hence, this pathway was found suitable.

- Since perception is the basis upon which decisions are taken, this pathway was found appropriate for dealing with corporate governance issues that require a global perspective.

3.4.2 Second Pathway: The Ruling Guide Pathway (P → J → D)

- Under this pathway, the decision becomes judgment-oriented, and decision-making relies upon the perceptions of individuals of the rules in force. Since corporate governance has become mostly rule-based, this pathway seems to be appropriate.
- The rules are expected to provide guidance whereby people can/will behave in particular ways while making decisions, and this is an important premise for this research.
- The rules are also considered to provide incentives that encourage people to behave in certain ways. Following the norms of corporate governance might provide incentives, in the form of increased firm value, and hence this pathway is found suitable.
- The fact that high levels of trust are at the foundation of this pathway, will help in increasing the association of individuals with social structures.

3.4.3 Third Pathway: The Analytical Pathway (I → J → D)

- Under this pathway, values and beliefs are expected to motivate the judgments of individuals involved in the decision-making process, which gives a new dimension to this research on corporate governance.
- When the decision-making process is considered from a cognitive perspective, it is important that the analytical pathway is considered.
- Since this pathway considers the provision of the greatest good for the greatest number of people, it was chosen for this research.

- The analytical pathway requires the availability of reliable and relevant information so that the individual is guided through the ethical considerations, which is one of the focal points of this research.

3.5 SUMMARY

There is a need to identify some pathways that guide an individual in his decision choice, based on the relevant ethical positions. Without the guidance of the pathways, making a choice would be difficult. This chapter provides the understanding, that each of the ethical positions taken in the pathways can help individuals to frame the problems involved in different ways and allow the implementation of certain types of information. The pathways dealt within this chapter also describe the ways in which an analysis can combine and utilise perpetual framing and information in order for the individual to arrive at a decision choice. Within this context, the basic tenets of ruling guide, expedient and analytical pathway were discussed within this chapter. Taken together, these pathways constitute the foundation of the present study's EPTM, which is used to fulfil the above-mentioned aims. On the basis of the implementation of the three pathways, combined with a literature review, the research questions and hypotheses are examined. The research questions and hypotheses relate to board characteristics, audit committees, profitability, liquidity and leverage and their impact on the firm's financial health as well as on the firm value. The impact of board characteristics on financial health and firm value was discussed in detail and the review of the past literature has produced mixed results, showing both positive and negative association between the variables. Similar results have been produced in the previous research on the influence of audit committees on the financial health and firm value. Research questions and hypotheses on the interrelationship between financial health, profitability, liquidity and leverage were also discussed, in order to develop the relevant research questions and hypotheses.

Chapter 4

THE ENVIRONMENT & CORPORATE GOVERNANCE IN KSA AND UK

4.1 INTRODUCTION

This chapter provides an overview on the KSA and the UK as background then it moves to outline various aspects of the corporate governance environments in the KSA and the UK. As has been identified in the description of what corporate governance is, different nations have different policies that govern the operation of businesses.

The examination of the corporation governance context in the KSA includes an extensive description of the environment there. It also includes substantial background information about corporate governance in the kingdom, including models, external and internal frameworks.

The part of this chapter covering the UK's corporate governance also provides a detailed description of the environment in and for that nation, including background information about the implementation of corporate governance in the UK. Additionally, this section discusses various codes and reports, to generate insight into the system and its use. The features of corporate governance systems in the UK are also surveyed in the later parts of this chapter, and the chapter covers the external framework of the UK corporate governance.

4.2 SAUDI ARABIA

In 1744, Mohammad bin Abdulwahhab returned from Makkah, the city in which he had been conducting Islamic scholarship, to Najd. Upon arrival, he started to preach to the province's citizens on the immorality of idolatry and other sins, and he enthusiastically expounded the teachings of the Prophet Mohammed (PBUH). However, this scholar found it difficult to carry out his preaching work alone and found that this limited his scope. So, he decided to form an alliance, in order to enhance his work. The alliance that was subsequently formed, of Sheikh of Dariyah and Mohammed bin Saudi, led to the formation of a government that was based on Islamic teachings (Hertog, 2011). Thus, the life of Mohammad bin Abdulwahhab led to the foundation of Saudi Arabia.

Over time, between 1902 and 1927, the power of the Al-Saudi family grew across the Arabian Peninsula, and this was aided by the government of the United Kingdom. The rule of the Al-Saudi family extended, to encompass most of the Ottoman land in the Arabian Peninsula. According to Al-Rasheed (2010), the reign of King Abdul-Aziz in the 1930s generated greater unity in the Arabian Peninsula under one flag, which has become the modern Saudi Arabia. The foundation of this nation was based on Islamic teachings, with the legal system strongly based on the Quran and the Sunna (Al-Rasheed, 2010). Thus, power and authority in the political environment of Saudi Arabia are deeply rooted in Islam. This is the reason Saudi society does not embrace the western culture but adheres to Islamic norms and values.

4.2.1. The Geography of the Country

Saudi Arabia subjugates most of the Arabian Peninsula and contains the largest percentage of continuous desert in the world. This is why some geographers refer to the nation as the 'Empty Quarter'. The eastern province of Saudi is dominated by oil wells.

Saudi Arabia is divided into four key geographical areas. Taking these in order of size, the largest is Najd a central plateau rising to a distance of 600 kilometres in the east and 1500 kilometres to the west (Al-Rasheed 2010). Figure 4.1 illustrates. The capital city of Saudi, Riyadh, is located in this region. The second region is the Hijaz, which spreads along the Red Sea to Aqaba Gulf up to the two holy cities of Medina and Mecca. To the south of Najd, the third region, Asir stretches to border Yemen. Asir is a fertile plain bordering the coast. The final area is the Eastern Province, which includes the oasis region of Al-Ahsa, close to the Persian Gulf that possesses the oil resource.

Since the KSA is home to the sacred sites of Mecca and Medina, it holds a special place in the hearts of all Muslims. Mecca is significant to Muslims because it is a sacred place of prayer, which can host more than one billion Muslim believers (Al-Moataz and Hussainey, 2012). Medina is referred to as a holy city because it is associated with Prophet Mohammed's emigration, and hosts his grave. Saudi is also a land of prophecy, from whence the genesis of Muslim region emanated and spread to the rest of the world. As a result of all of these significant reputations, Saudi hosts about two and half a million people annually, who come to participate in the Hajj ceremony.

The climate of Saudi Arabia is hot and dry, with cold nights and frosts appearing in the winter. Along the coastal regions, humidity is very high and during the summer, the temperatures are very high with cold nights. Most of the Saudi regions are a desert, with huge volumes of sand. The desert rises into hills and mountains on the western side, along the edges of the Red Sea. The highest place in Saudi Arabia is Jabal Sawda, which peaks at 3,133 metres. According to Al-Rasheed (2010), the main economic activity in the country is the extraction of oil, and the KSA is the world's leading exporter of oil.

The inland areas of Saudi, including Najd, the central province, and the desert regions share a stable climate. During the summer, the temperatures can be high, up to 45⁰ C, but the nights are very cold. During the winter, the temperatures change significantly and may fall to below 0⁰ C. During the spring and autumn, the temperatures can be mild, with an average of 29⁰ C. These climatic conditions show that the nation cannot depend on agriculture for income on a national level. Thus, there is need to ensure proper management of the oil resource so that the state can continue to enjoy the high profits from oil exports.

The climatic conditions of Saudi during different seasons, as they are described above, shows that the nation experiences harsh climatic conditions and a key result of this is that the country's water resources are highly valuable. The surface water in Saudi Arabia is mainly in the western region, and this provides the nation with about 10% of its water supply. Constructional and residential expansion with the decline of groundwater that led to an increase in the demand for desalinated water. The Saudi Government has established 9 desalination plants to product desalinated water. The rest of the water comes from desalinated and recycled water. The only natural resources that Saudi Arabia has oil and gas, with total oil reserves of 266.26 billion barrels (OPEC, 2017).



Figure 4.1 Saudi Arabia Map (World Atlas, 2016)

4.2.2. Revolutionary Oil

Oil was discovered in the KSA in 1936, and commercial production started in the years of World War Two. The nations rich with oil resource allowed their people to enjoy free health and education, without collecting taxes from them. During the Second World War, Saudi remained neutral almost until the war came to an end, although she had the status of a charter nation of the United Nations.

The fluctuation of international oil prices has always had a significant impact on Saudi Arabia because her economy directly depends on oil exports (Hertog, 2011). At the international level, there exist many politics that control decisions concerning oil prices. Saudi Arabia being one of the prominent producers of oil, political change in that country affects global oil market prices. Given the fact that Saudi is the world's primary oil producer, should worry investors when the nation becomes stable, more than when it is faced with political instability.

Three key factors affecting Saudi Arabia are its young population, the expectation by citizens of high standards of living and the presence of a foreign workforce with lower standards of living but high productivity. According to Al-Moataz and Hussainey (2012), the availability of oil reserves in Saudi Arabia has given the country an opportunity to import a workforce to work in the oil wells, so that nationals of Saudi can continue to enjoy high living standards. The economic framework that the Saudi

Government has embraced is not sustainable, due to falling oil prices, yet the population of Saudi is growing rapidly. Thus, rapid changes are taking place in the Saudi political landscape. In this context, a significant move was the replacement of the Ministry of Energy, Industry and Mineral Resources, in 1960 this had significant ramifications for the Saudi economy. The central bank of Saudi is similarly critical to the economy, as policies applied by the governor of that institution directly affect the economy in various ways. The governor also has the responsibility of controlling the sovereign wealth of the nation.

The current state of the Saudi economy is comfortable, but it is not sustainable. The older generations of the royal family had no interest in changing that lack of sustainability, but the younger generation, in particular the deputy crown prince, is highly dissatisfied with the situation. The political changes in Saudi Arabia will affect the oil market in the future, generating increased volatility of oil prices (Hertog 2011). Revolution comes with change in various aspects of government. The changes that are taking place in the political arena of Saudi Arabia is evidence that in the future, the nation will attain stability because these changes are in the major sector that drives the economy of the country. A focus on the Ministry of Oil and the central bank's leadership is likely to bring stability, hence investors will have a big reason to worry, because these political changes are likely to modernise and diversify the economy of Saudi. Hence, the economy will have a means through which it can conserve its culture.

4.3 THE CORPORATE GOVERNANCE OF SAUDI: BACKGROUND INFORMATION

The corporate governance of Saudi relates to the country's business environment, a grasp of which requires a clear understanding of Saudi politics, culture and economics. This section will explain the business environment of Saudi so that there is clarity concerning its corporate governance.

The state of Saudi Arabia dates from 1932, when the King Abdul Aziz declared the birth of the Kingdom of Saudi (Al-Moataz and Hussainey, 2012). This decision by the king was settled on following unification of the various regions of the Arabian Peninsula, so that they became a nation under one flag. The unity of the different parts to form the state of Saudi-created a strong kingdom, which to this day remains important

in the Middle East. The KSA, being located on the Arabian Peninsula, is situated in the geographical region of Western Asia.

Saudi Arabia has a monarchical system of governance, whereby succession remains limited to male descendants from the family of King Abdul-Aziz. Within the monarchy, there is centralisation, with the reigning king being the leader of the Assembly of Ministers. The Council of Ministers of Saudi Arabia is endowed with the responsibility of managing all of the kingdom's affairs, both internally and externally. This management includes co-ordination and organisation of the different arms or departments of the Saudi Government. The king remains the most powerful person in the kingdom, because all the fundamental authority and power is vested in him. The governance system bases the nation's constitution power on the Quran. Thus, all the laws of the nation base and all legal argument are based on the Islamic legal code of Sharia. The key concepts that guide the governance system of Saudi Arabia include fairness, equity and consultation as they are described in the Islamic legislation.

The religion of Islam is the fundamental influence upon all operations. This is because the foundation of the country dates back to the year when various Muslim leaders agreed to set up a state that was to occupy most of the Arabian Peninsula. With an important presence and role in the region, the KSA now serves as a participant in the Gulf Co-operation Council (GCC), the Organisation of Islamic Co-operation, the League of Arab States and the United Nations. The economy of Saudi is dependent upon oil exports; these contribute more than 90% of the national income and between 35% and 40% of the Gross Domestic Product (Alshehri and Solomon, 2012). Saudi Arabia hosts around 25% of the world's oil reserves and will therefore continue with production for many years to come. In the last quarter of 2016, Saudi Arabia led the world in oil production producing 9.8 million barrels per day (Hallwood and Sinclair, 2016). Figure 4.2 shows production by Organization of Petroleum Exporting Countries (OPEC).



Figure 4.2 (Source: Ft.com, 2017)

One of the areas in which corporate governance practices are particularly consequential, as has previously been noted, is the pattern of Foreign Direct Investment (FDI). As was noted by Kim (2010), commercial governance performs an important function with respect to investment and, furthermore, regarding the advancement of stock markets. Understanding the business governance of a country is important to investors in the security market, and both investment and the stock market are vital when it comes to growth of macro-economic aspects of an economy. Therefore, the level of corporate governance may be of paramount importance in attracting investors because it is the only indicator that investors look at before making the investment. The type and implementation of corporate governance allows investors to determine and understand the risk that they would be faced with when it comes to investments into a given economy.

Businesses are governed by the laws of a nation, thus, understanding the corporate governance of a country will show new investors what the law of that particular country says. It will allow investors to gain confidence in the efficacy of a nation's legal system when it comes to protecting the rights of foreigners. Heenetigala and Armstrong (2011) have stated that where there is sound corporate governance, investors can rest assured that the level of risk involved is limited. The other benefits that such governance conveys include the attraction of investment capital and improved company performance.

4.4 THE SAUDI ARABIAN CORPORATE GOVERNANCE MODEL

The literature highlights the existence of two types of corporate governance law, and to distinguish between the two requires the application and consideration of models. The two primary types of corporate governance model comprise the continental European stakeholder model and the Anglo-American shareholder model (Singh and Zammit, 2015).

The Anglo-American shareholders model, which is prominent in the international community, is composed of the following three components: firstly, shareholders; secondly, executives and thirdly, directors. The continental European stakeholder model is characterised by a high concentration of capital. Shareholders have common interests with the firm and participate in its management and control. Managers are responsible to a wider group of stakeholders.

Most firms in the KSA have systems of corporate governance which are aligned with many features of the Anglo-American model, since firms' components are the audit committee, the board of directors, and the shareholders.

Corporate governance systems in the KSA are characterised by the affordance of legal protections to all shareholders, considerable levels of transparency and high levels of information disclosure (mandated by law). Heenetigala and Armstrong (2011) argue that the KSA's model of corporate governance is akin to both the Anglo-American shareholder model and the continental European stakeholder model. Additionally, in the KSA there is legislation regarding insolvency and bankruptcy issues, while in the stock exchange market, there exists corporate control and development of takeover markets. The Saudi model also allows the capital market to be very liquid. According to its design, the board of directors is vested with all of the powers in, and control of, corporations. In terms of ownership, the governance law allows a structure of diffuse ownership, except when it comes to institutional investors. According to the contractual agreements that investors make, shareholders are in a position of enjoying their rights.

In Saudi Arabia, the corporate governance law has changed to allow all of the stakeholders involved to benefit, by giving every stakeholder the ability to exercise rights based on contractual agreements. Any contractual arrangement brings draws upon corporate law because the business law offers all relevant information relating to the ownership, structure, board members and the top executives, primarily by stating their responsibilities. International law governs all the financial institutions in Saudi Arabia, but all of the companies that participate in the SSE market must adhere to the national laws. That national legislation is subject to the Islamic law (Ghamdi, 2012). Therefore, participation in the Saudi business environment requires an understanding of both the national law and Islamic law.

Since Saudi Arabia takes insights and elements from the two primary models, it has managed to create a very strong corporate governance system, which protects the investors' interests and also gives all stakeholders corresponding provision. Like the Anglo-American shareholder model, Saudi Arabia gives shareholders their rights but also considers the rights of stakeholders. This allows Saudi to fit and work with the international capital market. Inspired by the continental European model, the aspects of globalisation that demand efficacy in the marketplace have been bolstered by the Saudi system of corporate governance, so that they remain active internationally. The origin of continental European stakeholder model lies with an assumption that business is a risky undertaking, but the risk falls to shareholders rather than the employees, and this encourages management to engage their staff with the board of directors' directions, and ensures informed decisions.

4.5 THE EXTERNAL CORPORATE GOVERNANCE FRAMEWORK FOR SAUDI ARABIA

Specific bodies hold the responsibility for monitoring business and business conduct in Saudi Arabia. This section examines those Saudi organisations that are in charge of registering, supervising, regulating and monitoring the operation of companies on Saudi Arabian soil. These bodies include the Ministry of Commerce and Industry, the Saudi stock market, the country's capital market authority, the Saudi Financial Agency and the Saudi Organisation of Certified Public Accountants.

4.5.1 The Ministry in Charge of Commerce and Industry

Prior to the integration of the Ministry of Commerce with that of Industry, Saudi Arabia maintained the two departments as different entities. The primary task mandated to this now combined department is to monitor all the companies listed on the Saudi stock market. Its other roles include the regulation, supervision and registration of companies. All of these functions are covered by the monitoring aspect because it is through monitoring that the ministry registers, supervises and enforces the regulations that companies must follow. The intention is to ensure that all of the businesses in Saudi are working in compliance with the laws of the country. The Ministry also plays a key role in monitoring other bodies, such as the Saudi capital market authority, the public accountants' organisation and the country's stock market.

4.5.2 The Saudi Arabian Monetary Agency

The agency that is officially named the Saudi Arabian Monetary Agency is more generally referred to as the central bank of the KSA. It was founded in 1952 and has a charter that mandates it to act as the central bank of the government and to issue currency. Given that it is the government's investment authority, the central bank performs a critical function in managing the KSA's assets in foreign countries, as well as its internal assets. The law of Saudi gives the central bank power to deal with all the banking affairs of the kingdom, thereby ensuring the co-ordination of government expenditure and investment. It is the only body that can print the national currency, which is the Riyal. Singh and Zammit (2006) state that this strengthens the currency of Saudi by stabilising its value. This approach allows the authorities to perceive when there is a need to print more currency, and when to reduce the money supply, so that the nation is not faced with internal inflation.

The central bank, which is the governmental bank, manages the foreign exchange reserves of Saudi Arabia. The monitoring policies that bring stability to the country's pricing system are developed by the agency, in order to let it maintain economic balance. The central bank also plays a key role in supervising all of the commercial banks operating in Saudi Arabia and has the function of monitoring the country's insurance companies and ensuring that they adhere to protection laws as stipulated by the government. All of the credit information about all of the financial institutions operating in Saudi is readily available from the agency. This is extremely important to

financial investors because it allows them to gather insight into target companies and allows them to invest on the basis of risk levels.

4.5.3 The Capital Market Authority (CMA)

The CMA reports directly to the Saudi Prime Minister. Back in the 1950s the authority operated informally, but in the 1980s, the Saudi Government applied regulations to govern its operations. The official year that is linked to the official functioning of the authority is 2004. The key role of the capital market authority is to facilitate the regulation and development of firms headquartered/registered within the KSA, thereby ensuring the stability of the environment in which they conduct their activities (Al-Matari et al., 2012). All of the regulations affecting companies pass through this body, to ensure they are attracting investment and enhancing transparency. The purpose of these operations is to ensure the protection of investors from any illegal activities in the market.

The CMA is managed by a board that comprises five members, appointed by the prime minister. The associates of this board are barred from undertaking any commercial activity or holding any interest in profit making projects, to ensure the impartiality of their decisions. The authority has generated important regulation of corporate governance practice; as the body that issues regulations and instructions it guarantees all parties involved in the Saudi Arabian finance market obey these rules (Al-Matari et al., 2012). The authority, through its regulations, ensures that the Saudi exchange market enforces the appropriate standards and assures transparent transactions. The body offers a very high degree of security, that protects investors and the public alike from unfair practices such as fraud and manipulation, and its work has increased the efficacy of the Saudi market for securities. Additionally, the authority has the mandate to monitor the commitment of various companies listed in the Saudi market.

The role that the CMA plays is pivotal because it is intended to develop and regulate the stock exchange by enforcing regulation that governs all players in the market. The role of protecting investors remains a key priority to the authority. This has allowed investors to invest in the Saudi exchange market without fear because their rights, especially their property rights, are assured by the authority. The assurance of security for investors in Saudi, by this administration, has created a stable market.

4.5.4 The Saudi Stock Exchange

The Arabic name Tadawul refers the Saudi stock exchange and means ‘the act of exchanging stock in the market’. In the country’s work to accomplish significant growth, the Saudi stock exchange plays a very critical role.

At present, the Saudi Stock Exchange (SSE) is a self-regulated body overseen by a nine-member board. Each member receives a nomination from the Saudi Capital Authority and, moreover, is appointed by the KSA’s prime minister, and together they constitute the monitoring device. According to Singh and Zammit (2015), the nine members of the board represent various agencies of the government, including the Ministry of Commerce and Industry, the Department of Finance and the state bank. Other members of the board are directors from companies listed on the SSE as well as licensed brokerage firms.

The SSE started to operate in the 1930s, and the first company to be listed was the Arab Automobile Company. Back in 1975, the Saudi economy experienced a boom that was linked to the globally increased price of oil and the buying of shares from foreign markets and sale of them on the SSE. Yet, even with such a significant improvement in the stock exchange, the Saudi market remained very informal and unorganised. The government was, ultimately, forced to generate and enforce regulation that would shape the trends and ensure continued improvement.

In 1984, the Saudi Government formed a committee that comprised the Department of Commerce and the Saudi Arabian Financial Agency. The role of these bodies was to provide regulations to control the markets’ activities. The committee’s work led to the establishment of the capital market authority in 2004, which ensure further provisions and rules for application in the stock exchange.

The announcement of the private scheme by the Saudi Government has attracted privatisation in the stock exchange in the nation such that vital sectors of the economy, such as family businesses, have gone public. The number of companies listed on the stock exchange has risen from 144 companies in 2011 to 179 enterprises in 2017 (TADAWUL, 2017). The SSE has become hugely attractive to foreign investors as a result of its increased security and stability. The stock exchange is considered to be the only body through which the Saudi Government can conduct the trading of securities.

The key objectives that the Saudi stock exchange strives for is that of ensuring fairness and efficacy in all operations of the stock market. The institution is also mandated with the responsibility of ensuring that integrity and quality are evident in all transactions in the stock exchange market. Moreover, it improves transfer capabilities and competencies through structured regulation that facilitate a thriving business environment.

4.5.5 Saudi Organisation for Certified Public Accountants (SOCPA)

The SOCPA is a body of professionals, established in 1991 under instructions from the Saudi Government's Department of Commerce. The primary responsibility of this body is to promote and enhance the accounting and auditing professions across Saudi Arabia (SOCPA, 2006). Its aim, in the course of pursuing this responsibility, is to work with professionals in the fields of accounting and auditing, to improve the standards of these professions. The organisation for certified public accountants plays a pivotal role in professional development in both the auditing and accounting disciplines. The three most important responsibilities that have been conferred on SOCPA by the Saudi Government, are its duties to undertake re-organisation of all Saudi-based audit firms, monitor their quality and grant them licenses for operation.

The other roles that SOCPA undertakes in order to improve the processes of auditing firms, are to encourage research in the fields of accounting and auditing, through funding and rewards. The body also publishes accounting and auditing standards through journals and books and is also the only organisation to set examinations for all fellowships in the Continuing Professional Education (CPE) courses. It also hosts management accounting conferences, to pass important announcements and information on to the public. Through this body, the Saudi Arabian accounting and auditing system has enjoyed greater transparency, because SOCPA ensures that the relevant financial professionals operating in the market are professionals and experts in the field of auditing and accounting.

4.6 THE SAUDI CORPORATE GOVERNANCE CODE (SCGC)

The SCGC plays a vital role in providing a legal environment that is supportive of the successful performance of Saudi listed companies. In this sub-section, the provisions of the Saudi Governance Code will be discussed some parts such as to part 1 (preliminary provisions), part 2 (rights of shareholders), part 3 (the board of directors), part 4 (company committees), part 5 (internal control), part 6 (the company's external auditor), part 7 (Shareholders), part 8 (professional and ethical standards) and part 9 (disclosure and transparency). The SCGC was established by the Capital Market Authority (CMA) in 2006, it updated and represented in 2017, for the first time in the history of the state, the effort of an official agency to create official corporate governance practices.⁷ According to the CMA, the code was formulated for the purpose of mitigating against rumours and fraud, the latter especially relating to insider trading (CMA, 2011).

- ***Part 1: Preliminary Provisions***

The preliminary provisions set out the definitions that are contained within the Corporate Governance Regulations. It sets out a definition of corporate governance, referring to it as leading and guiding the company through mechanisms that guide the relationships between board members, shareholders, and stakeholders, to ensure transparency, encourage competition, and promote fairness. The roles of individuals are described, with the role of executive and non-executive directors explained, with the former being a full time member of the executive management team whereas the latter is not. The board also requires an independent director, and there may be management executives or a senior executive whose responsibility it is to manage the daily operations and propose and make strategic decisions.

The nature of companies in Saudi means it is important to refer to relatives and company ownership, in particular holding companies such as Limited Liability (LLCs) or Joint Stock companies⁸ (JSCs). It is important to note that reference to a person includes their affiliates; an affiliate is a controlled or administers control, either directly or indirectly. In addition, substantial shareholders play a key role, and such individuals must have a five percent or over share in the company. Also, the term stakeholder

⁷ See Appendix A for an English translation of the Saudi Corporate Governance Code (SCGC).

⁸ (LLCs) is a corporate structure whereby the company's members cannot be held personally liable for the liabilities or debts of company (JSCs) is an organization falling between a partnership definitions and corporation regarding liability of shareholder .

includes anyone with an interest in the company, whether employees, customers, suppliers, and so on.

The types of action that may take place, whether beneficial to the company or not, are cumulative voting, whereby shareholders have a stake of the vote according to how many shares they own, and controlling interests, which involves influencing the actions and decisions of others, whether directly or indirectly. Remuneration is important, and this includes allowances and dividends, as well as bonuses linked to performance, and reasonable expenses.

Companies must be managed in accordance with best practice, and ensure the rights of shareholders as far as possible. Moreover, the Corporate Governance Regulations are mandatory, apart from under specific provisions. The regulations provide a clear legal framework for companies and set out shareholders' rights; the responsibilities of the Board and what the competencies its members should be; encourage the development of board members' skills, and call for transparency and fairness. In addition, the regulations seek to increase accountability and awareness of the importance of professional conduct.

- ***Part 2: Rights of Shareholders***

Article Four, sets out the fair treatment of shareholders, the protection of their rights and ensuring equality and Article Five lists the rights related to shares, such as the distribution of profits, the receipt of assets in the event of liquidation, attendance of assemblies, the disposal of shares, access to documentation, monitoring performance, the accountability of the Board, the right to request new shares, the recording of names in the shareholder register, access to articles of association, and the nomination and election of board members.

Article Six focuses on the shareholders' right to access to information, which should be communicated clearly; Article Seven sets out how that communication should occur, including shareholders not being allowed to intervene in the operations of the board unless they are a member.

The election of board members is essential to the success of the company, and Article Eight explains that the qualifications and experience of nominees must be carefully considered and the details made available to voters. The distribution of dividends is addressed in Article Nine, such as the prescription of net profits and the policy on their distribution.

The rights regarding the General Assembly include ensuring competencies, such as increasing capital, resolving to liquidate the company, allocating shares, and issuing resolutions. With regard to the Ordinary General Assembly, it can include appointing and dismissing board members, giving permissions to board members such as permitting specific activities, and monitoring the actions of board members, such as addressing ineffective management. In addition, auditing, the company's financial statement and assets are addressed at the Ordinary General Assembly. An Ordinary General Assembly must be held at least once a year, and the place, date and agenda must be shared at least ten days before it is held, and shareholders must be given the opportunity to participate. In addition, Shareholder Assembly meetings should be organised, with shareholders given the right to discuss matters raised at the General Assembly.

- ***Part 3: The Board of Directors***

The Board of Directors should be of a suitable size for the company (not less than three and no more than eleven), and the majority should be non-executive members, with at least two independent directors; in addition, their term must be for a maximum of three years. The conditions for membership of the board are: good leadership skills; academic and professional competencies; technical and leadership skills; financial knowledge, and have no serious health problems.

The company must set out the bylaws according to which board membership may be terminated, as well as terms of resignation. There are also issues that affect independence which need to be addressed, such as taking on an independent director to reduce bias, and evaluating and checking circumstances to ensure that independency is maintained over time. An independent director must not hold five percent or more of the company's shares or be representative of a person who does so, and they must not be a relative of a member of the board or the company, or be a senior executive. In addition, there is a time limit of nine years.

The Board of Directors is responsible for ensuring a duty of care and maximising the value of the company. It should guide the company towards achieving its objectives and set out plans, policies, strategies and performance indicators, which should be reviewed periodically. In addition, financial and human resources should be reviewed by the board, and internal control procedures put in place. Disclosure and transparency must be ensured, alongside effective communication channels.

The board itself should be governed by specific policies, including with regard to membership, and making recommendations for the General Assembly. The board should appoint a chairman, vice chairman and a managing director from among its members, and two positions should be held concurrently. Moreover, a single person must not have the sole power to make decisions about the company. The executive management must oversee all procedures and ensure that key tasks are carried out. Any potential conflicts of interest must be addressed, and risk management procedures put in place. Furthermore, Article 29 sets out principles of truthfulness, loyalty and care. Each board member has specific duties, which must be carried out with due diligence.

The secretary of the board plays an important role, which includes documenting Board meetings and writing the minutes, filing reports, disseminating meeting agendas, and coordinating the board members. The secretary must have a Bachelor's degree in finance, accounting or administration, along with at least five years practical experience. Board members must be provided adequate training for their roles, and familiarise themselves with the workings of the company, its strategies and objectives. Moreover, the Board should be assessed on an annual basis using performance indicators and any strengths and weaknesses should be identified, and the latter promptly addressed.

- ***Part 4: Company Committees***

Specialised committees should be formed by the board where necessary, such as to monitor activities, and appropriate remuneration may be set. Company committees should include non-executive members and the chairman must not be a member of the audit committee. A committee should operate according to the requirements of the board, and it should be allowed to seek out expert advice. Committee meetings must be documented, including the names of all attendees.

Another essential committee is the audit committee, which is formed according to a resolution of the Ordinary General Assembly. The number of members of the audit committee must be between three and five; these can be shareholders, and at least one member has to be independent, as well as one member being a finance or accounting specialist. The audit committee is responsible for monitoring the company's activities, and its reports, systems and financial statements, the results of which it should present to the board, along with any recommendations. If the board does not follow any of these

recommendations, it must provide justification for not doing so. The audit committee should hold a minimum of four meetings a year and should meet regularly with the company's internal auditor and external auditor, each of whom may call a meeting with the audit committee whenever they see fit. The audit committee should also put arrangements in place for employees to make their views known in confidence if they believe there any discrepancies in financial reports.

A remuneration committee may also be set up, which should provide a clear policy on remuneration for board members. This policy must be approved by the General Assembly and should be periodically reviewed. The remuneration policy must take into consideration the company's strategy and objectives, and encourage Board members to work towards the success of the company. Remuneration must be in accordance with the person's performance, skills and experience.

A nomination committee may also be set up to guide the selection of members, including re-nomination. It should put a policy in place that includes standards such as not including a person convicted of a crime involving dishonesty, and it should review the capabilities of board members on an annual basis, as well as issuing job descriptions. The company's board may also resolve to set up a risk management committee. The members of the risk management committee must be non-executive directors, and have thorough knowledge of risk management and finance. The risk management committee should develop a strategy to mitigate risk and introduce policies on risk management that are in accordance with the company's activities, as well as any factors that change, whether internal or external. This committee should determine risk and decide on what an acceptable level of risk is, as well as addressing risks that threaten the existence of the company. Moreover, it should check for any inadequacies and continually reassess the company's exposure, structure, and ability to deal with risk. Based on the aforementioned points, the risk management committee must report its findings and recommendations to the board. As well as making the board aware of risk, the committee should also make employees aware so that they understand the risks that may affect the company. The risk management committee should meet when required, and at least every six months.

- ***Part 5: Internal Control***

An internal control system must be put in place by the company to check that the company is complying with laws and regulations, and that policies and procedures on risk management, as well as other provisions of the board, are being adhered to.

To do so, it is necessary to set up departments for implementing an internal control system that manage risk and carry out internal auditing; in addition, external entities may be used to do this if necessary. An internal audit unit or department should monitor and assess the internal control system and ensure that employees comply with the relevant company policies and procedures, as well as laws and regulations.

An internal audit unit or department must include a minimum of one internal auditor, as recommended by the audit committee, who they will be responsible to. The internal audit unit or department must ensure that its employees have been trained and have the skills to carry out their duties. In addition, these employees must not work in any other area apart from auditing and internal control. The department is accountable to the audit committee and must take heed of its decisions. In addition, the audit committee must determine the remunerations of the manager of the audit committee according to the company's policy on remuneration. The audit unit or department must be allowed access to company information and documents without restriction.

An internal audit plan that includes issues such as risk management should be put in place that has been approved by the audit committee, and this must be updated on an annual basis. A written report, which details its activities, must be submitted to the board by the audit unit or department quarterly. Along with recommendations, an assessment of the internal control system should be included in the report, along with the procedures put in place and any failures to follow previous audit reports and the reasons for this. In addition, the audit unit or department should provide the board with a general report on its activities during the preceding fiscal year, which must also set out any failures to follow the approved plan and the reasons for this.

The report produced by the audit committee should be guided by the board and the recommendations of the audit committee. It should detail the procedures that have been put in place to monitor financial matters and risk management. It should contain an assessment of the risks being faced by the company and its systems, as well as an assessment of the Board and the senior management's overseeing of internal control systems; including how often the Board has been notified of internal control problems

and how these have been dealt with. Any failures in the internal control system, as well as any emergencies that have been faced, should also be set out in the report, including how these have affected the company's performance. The company's adherence to internal controls during the addressing of risks, as well as the company's risk management operations, should also be presented in the report. Finally, the company must maintain efficient records of audit reports and documents that highlight its achievements and recommendations.

- ***Part 6: The Company's External Auditor***

The company must employ an external auditor to check that its financial statements honestly express the financial position of the company. The external auditor should be appointed by the audit committee and must be authorised by a competent authority and have no conflict of interests with the company. The external auditor must write a report on this for submission to the Board and be responsible to the board for its actions.

- ***Part 7: Shareholders***

The relationship that the company has with stakeholders must be regulated, with policies and procedures put in place to safeguard stakeholders' rights, including on compensation should their rights be violated; complaint resolution; maintaining confidentiality; rules of professional conduct for managers and employees, and preventing discrimination and bias. Policies and procedures should be put in place to facilitate a complaints procedure, including having a dedicated telephone number or email, and specific employee, for stakeholders to make complaints or send reports. Employees should be encouraged to participate, with committees put in place to discuss issues and establish social organisations for their benefit.

- ***Part 8: Professional and Ethical Standards***

A policy for professional conduct and ethical values should be put in place by the committee to ensure members of the board and employees are performing in the best interests of the company. The policy should also set out how the Board and senior executives must comply with company laws and regulations and not abuse their position. In addition, the assets of the company should be used only to achieve the company's objectives, and there should be clear rules on information sharing.

Social responsibility should be addressed through policy, as well as social initiatives, and the methods for carrying these out, as well as reports on what has been done.

- ***Part 9: Disclosure and Transparency***

Policies and procedures on disclosure are relevant to Companies Law and Capital Market Law. Disclosure to shareholders and investors must be accurate, clear and timely. In addition, the company website should display matters on disclosure. The board's report should detail operations over the past year, as well as information on board members, members of the various committees and their performance, voting shares, and the company's plans and objectives. The risks facing the company should also be included, as well as details on the company's assets and liabilities, and operational results. All actions of the board must be set out, such as the dates of board meetings, members' remuneration, and any links to other companies.

4.7 REPRESENTATION OF ISLAMIC FIRMS BY KSA

Hayat and Hassan (2017) provide a new dimension to the effectiveness of corporate governance on the basis of the level of leverage. According to Hayat and Hassan (2017), Islamic firms are characterized by low level of leverage and can be expected to have better corporate governance because of the lower level of debt. Applying this concept of corporate governance in the context of KSA companies, it can be stated that Islamic label alone cannot guarantee better corporate governance standards as the environmental, social and governance criteria also significantly affect the working corporate governance mechanisms. However, Islamic principles also consider the environmental, social and governance standards and also socially responsible investing. Therefore, to this extent, the Islamic label of KSA companies can be said to promote the application of corporate governance principles.

It is to be recognized that Saudi Arabia has a unique legal structure which is a combination of modern concepts coupled with a conservative outlook of traditional Islamic principles (Al-Rasheed, 2010). However, the first set of corporate governance regulations on corporate governance issued by the Capital Markets Authority were generally in accordance with the global standards. Such regulations cannot be said to follow the Shariah principles strictly to represent the KSA companies as Islamic firms. The other corporate governance rules and regulations issued by the Saudi Stock Exchange (Tadawul) and Saudi Organization for Certified Public Accountants also follow global standards (Al-Majed, 2008). The attitude of Shariah law in the matter of protection of the interests of minority shareholders is vividly clear as the Islamic law

states that the interests and rights of all people must be protected against any expropriation (Alkahtani, 2013). The Saudi Arabian laws and regulations need to incorporate the Islamic principles as they apply to all aspects of life. Therefore, the Saudi regulators have the responsibility to consider fairness to all as stipulated by the Shariah law. However, the legal structures of Saudi firms and the way in which the companies mediate the application of corporate governance principles and the protection of the interests of minority shareholders depend largely on the Saudi statutory laws rather than on Islamic teachings. This is because of the fundamental differences that exist between Islamic law and Western rules and regulations.

Al-Harkan (2005) argues that the OECD principles of corporate governance and Shariah law perspectives on corporate governance converge on a certain point with little genuine difference between the two. However, the ethical basics of Western corporations do not correspond to religious moral values as the ulterior motive of the corporations is profit maximization and consequently the corporate governance principles focus on the emphasis of self-interest. The Saudi companies following the corporate governance principles and practices that are more in line with the Western standards, therefore, cannot be said to follow the Islamic law principles in their strictest sense. This is evident from the way in which the interests of minority shareholders are handled by the concentrated ownership of Saudi families.

4.8 THE ENVIRONMENT IN THE UNITED KINGDOM

There exists much diversity, both cultural and ethnic, in the United Kingdom. The Kingdom comprises four nations, each of which has a clear identity. These are England, Northern Ireland, Wales and Scotland. Understanding the diversity of the UK remains a crucial matter for all firms that wish to conduct business in the region. The fact that London is the European Union's financial centre allows the UK to be recognised globally as a leader in business undertakings.

This section covers the geography of the UK and provides an overview of the economic environment. The purpose of the following two sections is to afford the reader a comprehensive overview of the corporate governance situation in the UK, especially regarding its policies and systems.

4.8.1. The Geography of The United Kingdom

According to Overman and Winters (2015), the United Kingdom comprises Great Britain (that is, England, Scotland, Wales and Northern Ireland see Fig 4-3. There are also numerous islands that are part of the United Kingdom, including Shetland, the Isle of Wight, Scilly Isles, Anglesey and Orkney. The UK is an island nation, located in the western part of Europe, off the coast of France. The kingdom lies between the North Sea and the North Atlantic Ocean. The approximate total area of the UK is 245,000 square kilometres (Overman and Winters, 2015). The fact that the UK is an island gives the country an advantage when it comes to export and import business. During the summer, the UK experiences cool climatic conditions, while the winters are cold. The United Kingdom has natural resources including coal, natural gas, tin, petroleum and zinc among many other resources.

The United Kingdom's landscape is very varied. It ranges from the highest mountains in Scotland to the lowlands in England. Northern Ireland hosts the largest lake, Lough Neagh, which covers an area of approximately 153 square miles. The fact that the UK is a small island makes her rivers small, lengthwise. The longest river is the Severn, which is 338 kilometres in length. It starts in Wales and enters the Atlantic Ocean at Bristol in England (Overman and Winters, 2015).

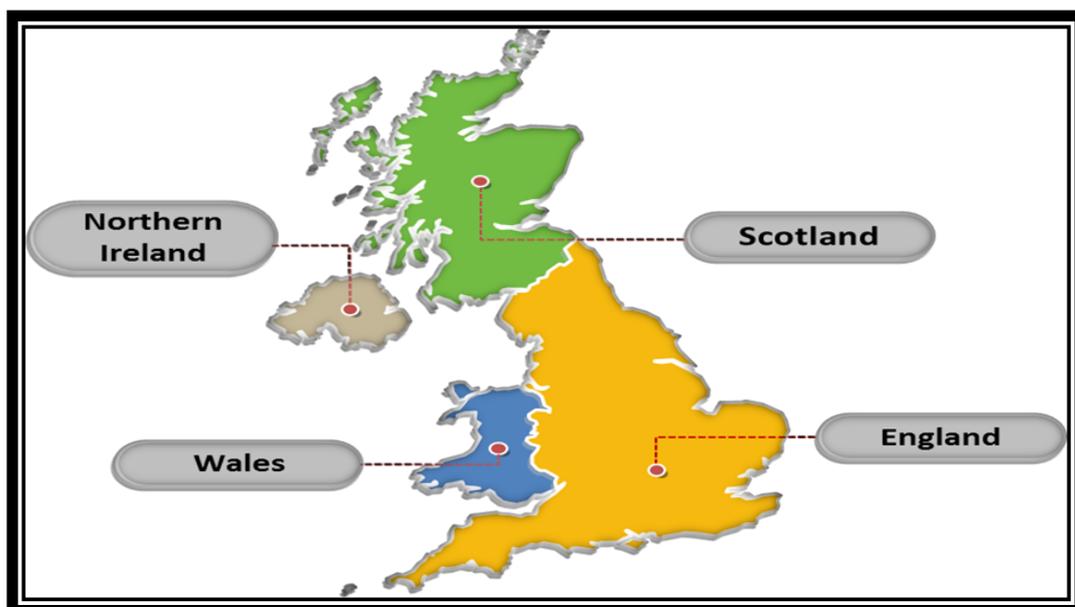


Figure 4.3 Map of the UK (World Atlas, 2016).

4.8.2 Economic Overview of the United Kingdom

The United Kingdom is identified as a complex economy, with diverse economic activities that range from industrial operations through services industry to agricultural production. The UK is classified as a capitalist economy; that is, an economy whose system is based on the private ownership of capital. With regard to the technological status of the UK, this is comparable to that of the United States (US). Additionally, industries which currently operate in the UK include the production of machine tools, automation equipment, hospitality, ship building and the manufacturing of electric power equipment. Chen and Bouvain (2009) claim that the leading employment sector in the UK economy is the service industry (79.1%) followed by the manufacturing sector (18.9%) and lastly the agricultural sector (1.1%).

Although agricultural production contributes less than 1% towards the UK's gross domestic product (GDP), it is very productive, particularly in livestock keeping. In livestock production, cattle and sheep are the main, established, animals that are reared. Some of the crops grown in the UK include potatoes, wheat, beetroot and barley. Three-quarters of the UK's land is utilised for farming activities. The fishing sector is also developing but is currently faced with depletion in terms of fish volume in the traditional fishing regions.

In terms of mineral extraction and processing, the UK possesses many natural resources. It ranks tenth worldwide in oil production, having vast natural gas reserves (Chen and Bouvain, 2009). However, the production of oil is dropping rapidly. The economic sectors in the UK that have the highest potential are information and communication technology, aviation industry, biotechnology and the renewable energy production sector.

The service sector employs about 80% of the population and makes about three-quarters of the total contribution towards GDP. It remains the key driver of the nation's economy. London, which is the financial centre of the UK, is the largest financial marketplace in Europe.

4.9 CORPORATE GOVERNANCE IN THE UK: BACKGROUND INFORMATION

Corporate governance in the UK is guided by various codes that encompass policies, laws and customs on how the nation conducts its business. The UK's corporate governance codes serve as checks on the powers and authority that are wielded by corporate directors. The foundations of corporate governance are deemed to be accountability, transparency, independence and fairness. The purpose of this section is to consider several reports which document the ways in which corporate governance in the UK has evolved over time. Through these reports, and codes, the researcher clarifies the relevant background and context as they relate to the UK's corporate governance. The main reports included in this section are: firstly, the Cadbury Report (1992); secondly, the Greenburg Report (1995); thirdly, the Hampel Report (1998); fourthly, the Combined Code Report (1998); fifthly, the Turnbull Report (1999); sixthly, the Myners Report (2001); seventhly, the Higgs Review Report (2003); eighthly, the Smith Report (2003) and, finally, the Combined Code. These various reports and codes offer insight concerning the background to UK corporate governance.

4.9.1 The Cadbury Report, 1992

According to the Cadbury Report (1992), the term 'corporate governance' refers to the system by which a firm's operations are regulated, guided and overseen. The Cadbury Report was the product of a committee that addressed financial elements of corporate governance in the UK, and the central issue the report sought to deal with was that of how corporate governance systems are constructed and implemented. In practical terms, the practical objective of the report was to ensure that a code of best practice could emerge, based on its findings. The Cadbury Committee was established in 1991 by the Financial Reporting Council, members of the accountancy profession, and the London Stock Exchange (Cadbury, 1992).

The reasons underlying the establishment of the Cadbury Committee include a growing lack of confidence around matters of investor faith in listed companies. Also, listed companies were collapsing at an alarming rate, for financial reasons, at this time. Thus, there was a need for intervention. Additionally, there was a lack of accountability among board members on matters relating to their pay. Moreover, some auditors were involved in the signing off of some corporate accounts that eventually turned out to

contain misinterpretations of fact, and so professionals in that field faced the loss of their self-regulatory status

The genesis of the current corporate governance in the UK economy lies in the Cadbury report of 1992. The collapse of many high-profile corporations in the UK led to the establishment of the Cadbury Committee, which was asked to research the means by which companies might be improved financially. A core purpose of the report is to offer protection to the weak, and widely dispersed, shareholders against the selfish interests of directors and managers. Shareholders are the sole proprietors of the company, while directors are the guardians of the company's assets and the managers are the users of the company's assets and carry out these roles to sustain and add value to shareholders' investments. The Cadbury Report brought about the reform that shifted directors towards increased accountability and engagement with shareholders. This led to a still greater change, in the field of corporate responsibility towards each company's various stakeholders. According to this report, corporate governance should form the basis of sound practice by the company board, control the operating environment, facilitate disclosure of information and transparency in operations, establish clear rights for all shareholders and, finally, the board should remain conformist.

4.9.2 The Greenbury Report, 1995

The Greenbury Committee was established to address concerns that members of the public and shareholders had raised, concerning the remuneration of company directors. Themes that are evident in the report include accountability, full disclosure, responsibility, improved performance and the alignment of the directors' interests with those of the shareholders (Bhimani, 2008). The Greenbury group worked to identify the best practices regarding these matters, with a view to developing codes of conduct to improve the situation.

At this time, shareholders and the public perceived that executive remuneration tended, in some contexts, to include generous share options in private utility industries, and that this was inappropriately skewed towards the directors' best interests. There was also concern expressed about amount of compensation that was given to departing directors. The Greenbury Committee's view on the matter was that UK corporations deal with issues of directors' remuneration in the most sensible and responsible manner. The compensation levels of the directors relied on the standards set by Europe, and the

success of any company's operations depends solely on executives' commitment to their leadership role. In light of the code of best practice the Cadbury Committee had devised, the Greenbury Report stated that when conflicts arise between shareholders and directors, it is necessary to establish remuneration committees to ensure that objective decisions can be made (Sheridan, Jones and Marston, 2006). The board must contain a specified proportion of non-executive members, within the agreed terms of reference, and chairpersons of the remuneration committee should report directly to the company's shareholders.

4.9.3 The Hampel Report, 1998

The Hampel Committee was formed according to the recommendation of the first two committee works, that there should be a separate and independent committee to enact their works. The work of the Hampel Committee was to ensure implementation of the outcomes from first two committees, i.e. Cadbury and Greenbury. The Hampel Committee was also established to examine all of the matters raised in the previous reports. Therefore, it is clear that the establishment of the Hampel Committee was not linked to any scandal, but rather was an approach to corporate governance (Bhimani, 2008). The final report of the Hampel Committee was produced in January 1998 and accompanied by a draft code of practice document that set the principles that embraced the Cadbury and Greenbury reports. The report was delivered to the London Stock Exchange, which went on to publish a consultation document that formed the basis for the publication of the Combined Code of 1998.

4.9.4 The Combined Code, 1998

The Combined Code formed an appendix to the Financial Services Authority's Listing Rules and led to the insertion of a new paragraph; 12.43A. This new provision became effective for all companies when documenting their annual reports as from the period that ended 31/12/1998. The Combined Code stated that all annual reports must have a narrative statement that reflected, and generated an understanding by shareholders of, the application of codes given in Section I of the Combined Code (Sheridan et al., 2006). This means that every annual report was bound to include a statement explaining, in detail, how the company has complied (or not) with the provisions of the law.

4.9.5 The Turnbull Report, 1999

The Turnbull Report (1999) was published to set out best practice regarding internal control issues, for all firms listed on the UK's stock market. These were the guidelines for the directors of companies, as far as internal control of business was concerned. According to Ozkan (2011), the core purpose of the report was to educate the directors on their obligations under the Combined Code of 1998. The boards were mandated with the responsibility of maintaining good internal control measures for their corporations. Those internal control measures must be correctly audited at set intervals, so that the company can demonstrate the transparency of its business, to its stakeholders. Auditing is undertaken to ensure that the corporation's financial reports reflect its responsibility, and to detect any frauds within the firm.

4.9.6 The Myners Report, 2001

The main agenda of this report was to offer policies and guidelines around institutional investments in the UK. The UK Government felt that institutional investors paid very little attention, and allocating proportionately fewer resources to, their holdings in companies that were not listed on the stock market.

The main issues that the Myners Report addressed, were those relating to pension funds. The largest of these problems was the question of whether institutional investors were acting in the best of the interests of the beneficiaries of their investments (Ozkan, 2011). The low rate of institutional investment in pension funds was a key concern for this report and was tackled in a bid to ensure greater benefit for investors.

4.9.7 The Higgs Review, 2003

The Higgs Review took as its focal point the purpose and efficiency of non-executive directors within firms. Ultimately, the report published by the Higgs Review sought to reinforce the provisions of the Combined Code (1998). In light of the report, firms in the UK were required to conform to the Combined Code's provisions and accompany this with explanations to their shareholders. The scandals that had faced some US companies, including Enron and Cogeneration need for the UK Government to establish criteria that would prevent such scandals from happening to companies within their jurisdiction (Bhimani, 200). The report arising from the Higgs Review recommended

that there should be greater understanding of the role of non-executive board members, so that the efficiency and efficacy they added to the company could be realised. According to this report, an active board was a critical aspect of effective corporate governance in the UK.

4.9.8 The Smith Report, 2003

The Smith Report was primarily concerned with the independence of auditors. Issues concerning this were raised as a result of the Arthur and Enron scandals in 2002. The Smith Report recommended policies that are now incorporated within the Combined Code for corporate governance. The recommendations made in the report received significant support from the EU Commission, which applied them to listing rules for the stock exchange in London. The auditors examining a company's financial reports were instructed to look into a firm's corporate governance, in order that they would understand whether its structure supported the independence that must be accorded to its auditors.

4.9.9 The Combined Code, 2004

Company law in the UK contains extensive provision for, and details aspects of, the Combined Code, the purpose of which is to ensure the efficacy of corporate governance practices among firms listed on the London Stock Exchange (LSE). The law surrounding the listing of businesses in this stock market is influenced by the combined code and requires companies to describe how they have complied with the provisions of the Combined Code (Sheridan et al., 2006). Those enterprises that have not observed these provisions must offer a detailed explanation as to why they have failed to apply the code in their reporting. Therefore, the Combined Code demands either compliance or explanations. The code offers some general guidelines that, when followed by corporations, generate best practice in financial reporting. Privately owned companies are also required to conform to the code, but it is not mandatory for them to disclose compliance.

4.10 UK CORPORATE GOVERNANCE CODE

The UK Corporate Governance Code (formerly the Combined Code on Corporate Governance) (“the Code”) prescribes expected actions and behaviour of the board directors which includes setting the tone on values throughout the company. The Code sets out standards of good practice in relation to issues nine sections such as leadership, effectiveness, accountability, remuneration, and relations with shareholders⁹.

- ***Section A: Leadership***

The Board of Directors plays a key role in the leadership of a company, and has a major impact on its success. This is because the Board is responsible for setting out the strategic aims of the company, along with addressing risk assessment and making sure that shareholders’ interests are met. In order to carry out its leadership function effectively, the Board should meet on a regular basis according to a schedule that contains matters for deliberation. Furthermore, the number of meetings should be recorded and noted in the annual report. The annual report should also contain the names of the chairman, deputy chairman, senior executive, and other members of the board.

The board is led by the chairman, and he or she is responsible for the agenda and the smooth running of Board meetings, including the disseminating of information. As well as executive members, the Board should include non-executive members, who should check the integrity of financial information, and make sure that the company’s goals are being met. Non-executive Board members are responsible for appointing and removing executive directors, and they are required to decide on the amount of remuneration the executive directors will receive. This ensures a level of independency, especially as shareholders should be able to approach the senior independent director if required.

- ***Section B: Effectiveness***

There are several ways to ensure effective board leadership, in particular by individuals on the board having a range of skills and experience, as well as thorough knowledge of the company. A range of executive and non-executive Directors is important in order to make sure that no specific group or individual dominates the decision making process. Moreover, to qualify as a board member, specific rules must be applied. For

⁹ The UK Corporate Governance Code is provided by the Financial Reporting Council (FRC,2016) in Appendix B

example, for more than nine years, the member should not have served on the board; the member and the company must not have a material relationship in the last three years; there must be no connection between the member and other companies' senior directors; the member must not have received remuneration from a company pension or even shares; there must be no ties between the member and the company, through directors or employees; and the member must not be in the company's employ for more than the last five years. This is in order to ensure that good leadership and shareholders' needs are prioritised.

The essential leadership role that the board plays means that appointment to the board must be rigorous, as well as transparent. Candidates should be appointed to the board based on merit, including their skills, experience and personal qualities. Appointments should be overseen by a nomination committee, with formal procedures followed and a meeting chaired by an independent person or a non-executive board member. Specific terms should be adhered to, for example if a board member has been appointed for six years in a row, this decision should be thoroughly analysed. To ensure useful and wide ranging contributions, diversity of the Board should be ensured, with a specific policy in place that addresses issues such as gender.

In order for leadership to be effective, Board members must be prepared to allocate enough time to the company and be available at critical times. If Board members have other significant commitments, these must be made clear to the Board and noted in the report of the Annual General Meeting, including any changes and the amount of time involved. To ensure an effective Board, induction training should be provided to all directors, and they should engage in professional development and regularly update their skills and knowledge, along with being familiar with the company and any changes. It is the responsibility of the chairman to provide the resources for this and discuss the directors' needs with them, and the company must provide access to operations and staff.

In order for the Board to run effectively, it should be provided with accurate and up to date information in plenty of time, and if directors are unsure of anything they should ask for a further explanation. Information should pass smoothly between the Board, the committee and management, and this is the responsibility of the secretary. In addition, directors should be able to access independent professional advice where it is essential to their duties.

The board itself should be evaluated on an annual basis (or every three years for FTSE companies), with any strengths recognised and weaknesses addressed; this may require new members to be appointed or even resignations. The performance of the chairman should be evaluated by the non-executive directors while considering the opinions of the executive directors. Directors must be re-elected at regular intervals, but only where performance is deemed to have been satisfactory. For FTSE 350 companies, this re-election must be by shareholders at the annual general meeting according to relevant biographical and performance information.

- ***Section C: Accountability***

A number of procedures should be put in place to ensure the accountability of the Board, and all of the information put forward by the Board must be fair and balanced, and easy to understand. The annual report should include an explanation of accounts along with other relevant information, such as the business model being used, that will enable shareholders to carry out an assessment and make informed decisions.

The Board is also responsible for risk management and internal control systems. Therefore, the annual report should describe how the assessment of key risks to the company has been carried out, especially where such risks pose a high level of threat and may affect performance or even lead to solvency or liquidity. The Board must set out contingency plans and state how these risks are being managed or prevented. In addition, formal arrangements, which should be transparent, must clarify the relationship of the company with its auditors. To achieve this, the company should appoint an audit committee made up of an appropriate number of competent executive and non-executive members according to the size of the company, and their roles and responsibilities should be listed in the terms of reference; for example, monitoring financial performance and statements, reviewing the company's internal control and risk assessment systems, making recommendations to shareholders, monitoring the external auditor's independence, and identifying areas of improvement. Furthermore, the audit committee should make provisions for staff to raise any concerns they may have, and investigate any improprieties.

- ***Section D: Remuneration***

Executive directors may receive remuneration, but this must be for increasing the success of the company in the long term. Moreover, remuneration must be rigorously checked by a remuneration committee made up of two or three independent non-executive directors or consultants, in accordance with similar companies, and made transparent. Consideration must also be taken of employees' salaries and working conditions when deciding on pay increases. There also needs to be a balance between remuneration that is performance related and one that is fixed and between remuneration that is deferred and one that is immediate. Furthermore, performance is not only finance related, but also measured according to other factors that are likely to influence the long term success of the company.

Considering executive directors' remuneration that is based on performance, specific provisions that allow the company to withhold or recover payments when required, should be followed by the remuneration committee. A remuneration report should set out levels of remuneration according to the role and the level of commitment required. Moreover, non-executive member should not be given share options as this may affect their independence. Possible compensation in the event of the early termination of a director's position should be decided on, as well as issues such as pension contributions, and periods of notice must be less than a year.

The procedure for producing policy on executive remuneration must be formal and transparent, and the director themselves must not be involved in decisions about their own remuneration. There may be conflicts of interest, and the remuneration committee must consider these. The remuneration received by senior management should also be considered by the remuneration committee as well as being decided on by the board. Any long term incentive schemes must be agreed on by shareholders, with due consideration given to any changes to existing schemes.

- ***Section E: Relations with Shareholders***

It is imperative for effective dialogue to exist with shareholders and an atmosphere fostering mutual understanding should be cultivated by the board. In addition, the dialogue should be in accordance with the company's objectives. Contact typically takes place between the chief executive or finance director and shareholders, and the chairman must make all of the board's directors aware of any concerns that arise.

Moreover, the board should strive to ensure that the views of shareholders are considered, and it is the responsibility of the chairman to inform the board of these views. Areas of concern that should be discussed with major shareholders are governance and strategy, and non-executive shareholders should be given the chance to attend meetings with major shareholders. Good record keeping is essential, and the annual report should include the action taken to obtain the views of major shareholders, such as through surveys, face-to-face discussions, or briefings from analysts or brokers. General meetings provide the opportunity to communicate with shareholders and investors, and they should be encouraged to participate. For purposes of clarity, a separate resolution should be put forward for each specific issue, and proxy appointment forms should be used to enable shareholders to vote in favour of or against the resolution, or to abstain from voting. However, if a vote is withheld, it must be announced that it will not be counted towards the overall result. Any proxy appointments made for general meetings must be recorded. If voting takes place via a show of hands, all of the necessary information must be made available as soon as possible, such as on a website, as well as at the meeting. In addition, the votes should be properly recorded, including the number of votes for and against the resolution, and any withheld votes.

It is important that the chairs of the audit committee, the nomination committee, and the remuneration committee be present during the Annual General Meeting (AGM) to answer to the directors and shareholders. Before an AGM takes place, an AGM Notice that includes any relevant information or papers must be sent out to shareholders 14 or days before a general meeting or an AGM, respectively. In this way, shareholders have enough time to consider the Notice and the accompanying information.

4.11. THE EXTERNAL CORPORATE GOVERNANCE FRAMEWORK IN THE UK

The purpose of this section is to outline the external structure of corporate governance in the UK, and so the stipulations of the agencies that perform a key function in establishing this external framework are examined. Such agencies include the Department for Business, Energy and Industrial Strategy, the Bank of England, the LSE and British bodies representing accountancy disciplines and professionals that give qualifications in accounting, which include:

- (i) Institute of Chartered Accountants in England and Wales (ICAEW);
- (ii) Association of Chartered Certified Accountants (ACCA);
- (iii) Chartered Institute of Management Accountants (CIMA);
- (iv) Associated of International Accountants (AIA);
- (v) Chartered Institute of Public Finance and Accountancy (CIPFA).
- (vi) Institute of Chartered Accountants of Scotland (ICAS)

4.11.1 Department for Business, Energy and Industrial Strategy (DBEIS)

This department was formed in 1970, following the merging of the UK's board of trade and the technology ministry. The DBEIS, in 2007, was classified into two separate departments: the Department of Business, Enterprise and Regulatory Reform and the Department of Innovation, Universities and Skills. The latter of these departments is primarily concerned with facilitating economic growth (Denyer and Neely, 2014). In order to attain the objective of economic growth, the agency management invests skills, innovation, and talents to promote business operations. It also works to offer protection to consumers within UK territory.

Much of the DBEIS's provision is achieved through reduction of the impacts of regulation upon businesses. The DBEIS is chiefly concerned with issues associated with corporate law, innovation, economic development, employment law, growth, consumer law, science, energy and trade. These are critical issues that surround the business environment thus, understanding the department and its role well will allow investors to understand their rights and the obligation of the UK business environment to their enterprises.

4.11.2 The Bank of England

The Bank of England is the UK's central bank that regulates money supply in the country and offers regulations to govern all the other commercial banks. The Bank of England has acted as a government bank since 1694. Although the government owned it then, the bank could make monetary policies as an independent entity (Denyer and Neely, 2014). The mission that the bank pursues is to deliver stability on the aspects of monetary and finance for the people of the UK. Monetary Policy is a very critical element of corporate governance, as it creates the environment for investors, ideally one that will encourage them to enter the market. This is because through monetary policies, an economy can enjoy stable product prices and confidence in that nation's currency. Through the Bank of England's Monetary Policy Committee, the UK brings transparency in the decision-making process, and determines the interest rates that are to be imposed by the commercial banks.

4.11.3. London Stock Exchange (LSE)

In the history of the UK's corporate governance development, the London Stock Exchange has played a critical role in strengthening the code that attracts good practices. The LSE established the immediate credibility of the UK's corporate governance code by giving additional requirements as far as listing rules are concerned (Riordan and Storkenmaier, 2012). One of the notable stipulations of the UK's corporate governance code (CGC) is that all listed companies on the LSE must 'comply or explain'. The LSE heads up diversified stock exchange business in the UK. It has a listing of more than 3,000 companies that are quoted in trade across all the markets that LSE deals with. For Europe, LSE remains the largest marketplace for liquid equity. The aim of the LSE is to create a business environment that is sufficiently and appropriately flexible, as far as regulations are concerned. To attain this objective, the LSE has determined that the companies listed on its market may acquire their shares and hold them in treasury.

4.11.4 British Accountancy Bodies that Issue Qualifications

All nations in Europe have established the minimum qualifications that an individual must have to be deemed a professional in the field of accounting. There are set standards that all students need to attain if they are to be accorded the relevant professional titles. For instance, in England and Wales, achieving membership of the ACA requires each candidate to pass through two stages of professional development; professional and advanced. The professional stages require the students to take 9 examinations, while at the advanced stage, they take two exams and submit a case study. In order to complete all of these steps, a student must take a training contract that will last three to five years.

The purpose of this section is to examine several accounting agencies in the UK which are involved in the matter of corporate governance.

- ***The Institute of Chartered Accountants in England and Wales (ICAEW)***

The ICAEW now has 147,000 members in 155 states, and functions under the Royal Charter. The body regulates and offers supervision under the provisions of the statute audit body in the UK. The other functions of this organisation are to guide all local audits of UK corporations, and to monitor markets and firms for money laundering activities (Riordan and Storckenmaier, 2012). Moreover, the institution has regulatory responsibility, through the licensing of probate services. In other words, it the body that is in charge of insolvency regulation in the UK.

The ICAEW also works to bring about a sustainability in public professions that leads to donor funding, thereby building initiatives across Europe, Africa, and Asia.

- ***Association of Chartered Certified Accountants (ACCA)***

The ACCA is an international body of professionals that has 188,000 registered members across 178 nations. It was granted a Royal Charter in 1974. The Association is committed to acting on behalf of and upholding the interests of the public globally, through its network of 100 offices and centres. The Association recognises statutory audits in the UK, Ireland and Zimbabwe, while in South Africa and Australia, the body holds recognition for taxation purposes (Matthews et al., 2013).

- ***The Chartered Institute of Management Accountants (CIMA)***

The CIMA is an organisation for management accounting professionals, that offers globally-recognised qualifications and expertise. The courses provided by CIMA give their students access to diverse career opportunities, providing them with expertise in many areas of finance, and decision-making skills. A recognised advantage of CIMA training is that it offers continuous professional development for its students. Matthews et al., 2013 argue that the recognised supervisory bodies within UK corporate governance through do not give sufficient credit to CIMA, making it hard for members of this institute to conduct audits in UK corporations. Auditors who are CIMA qualified must also become registered members of a recognised supervisory body in order to carry out statutory audits in the UK with CIMA qualifications.

- ***The Association of International Accountants (AIA)***

The foundation of this association dates back to 1928, and it was built with the aim to promote the concept of international accounting. This objective is attained through a network of accountants that extends worldwide. The AIA works with the interests of the public at heart, by offering its members regulations that guide their practice. The AIA undertakes accounting and auditing roles in Ireland, and supervisory roles in the UK through the Money Laundering Regulations, 2007. The AIA seems to partner with other financial organisations to generate trust, clarity and international standards in the accounting profession.

- ***The Chartered Institute of Public Finance and Accountancy (CIPFA)***

The CIPFA was established in 1885. It is the sole accountancy body in the UK to specialise in public services. This specialisation is reflected in its ambition to advance public finance through best accounting practices. The CIPFA works globally, with governments and all accounting professionals, to promote and support international accounting standards. The institution offers education and training that is geared towards high-quality advisory services in finance, information and consultancy services for all corporations. It is a member of Accountancy in Europe (Matthews et al., 2013).

* *Institute of Chartered Accountants of Scotland (ICAS)*¹⁰

The Institute of Chartered Accountants of Scotland (ICAS) is the oldest professional body created in the year 1854 by a Royal Charter, having more than 20,000 members in the UK and also in more than 100 countries across the world. The Institute can be regarded as an educator, examiner, regulator apart from having the distinction of being a thought leader to steer the profession of accountancy. ICAS has about two-thirds of its members serving prestigious business organisations in the UK and in other countries, while the remaining members pursue the practice of chartered accountancy with the Big Four or other medium and small sized firms. There are about 3000 students currently under training with the aspiration to become full-fledged chartered accountants. The Institute regulates and monitors the conduct of its members and the firms. ICAS is considered as a “Recognized Qualifying Body and Recognized Supervisory Body” under the Companies Act, 2003 in the jurisdiction of Ireland. The ICAS is also a recognised supervisory body for the registration and supervision of auditors in the UK. In addition, the Institute is a member of the Consultative Committee of Accounting Bodies in the UK. With the backing of the expertise and professional knowledge of its 20,000 members along with technical and specialist committees, the Institute has been offering valuable guidance in varied financial and economic policy areas. ICAS has been taking initiatives in the area of global accounting standards setting. It can be stated that the ICAS as an oversight body and professional accounting institution has a large part to play in regulating and guiding the accounting profession in the best interest of the public. The ICAS plays a commendable role in the provision of solutions and innovative ideas that will help in supporting the establishment of government policies and standards of accounting and auditing practices.

¹⁰ <http://icas.org.uk/default.aspx>

4.12 COMPARING BETWEEN UK & KSA

In table 4.1 a summary comparing between UK & KSA that explains more information such as geography, demography and economic. In table 4.2 is shown the similarities and differences corporate governance in UK & KSA.

GEOGRAPHY	UK	KSA
Location	The UK is located off the north western Europe coast, and is bordered by the Atlantic Ocean, Irish Sea, Ireland, Celtic Sea, North Sea and English Channel.	is a country situated in Southwest Asia, the largest country of Arabia, by the Arabian Peninsula, bordering its western highlands, along the Red Sea to the east, along the Persian Gulf and the Red Sea, north of Yemen.
Map References	Europe	Asia
Natural Resources	Natural gas, limestone, chalk, gypsum, silica, rock, salt, china clay, iron ore, tin, silver, gold, coal and petroleum.	Natural gas, petroleum, iron ore gold and copper.
Capital	London	Riyadh
DEMOGRAPHICS	UK	KSA
Population	66,573,504	33,926,519
Median age	40.5%	30.2%
Languages	English	Arabic
Religion:	Mostly Christianity	Mostly Islam
ECONOMY	UK	KSA
Currency	Great British Pounds (GBP)	Saudi Riyals (SR)
Annual GDP	2622.43(\$ Billion)	683.83 (\$ Billion)
GDP - Real Growth Rate	1.3%	2.50%
Labour Force	32535.00 (Thousand)	11168.50 (Thousand)
Unemployment	1016.30 (Thousand)	847917.00 (Thousand)
Trade Balance	£-3.3B	184.7 (SR Billion)
Exports	52623.00 (GBP Million)	286111.00 (SAR Million)
Imports	55852.00 (GBP Million)	101438.00 (SAR Million)

4.1 A summary comparing between UK & KSA

Source: Trading Economics,2018

Similarities	Differences
1. The corporate governance practices in the UK and KSA incorporate the elements of global standards of corporate governance.	1. The concentrated ownership structure in the KSA companies might lead to the expropriation of the rights of the minority shareholders which is not the case in the UK. The family ownership in the UK has gradually been replaced by the institutional ownership (Alkahtani, 2015).
2. Both the UK and the KSA adopt a single or unitary board system consisting of executive and non-executive directors.	2. The Saudi security market is being governed by an ineffective legal system offering only weak protection to the interests of minority shareholders. The UK has a well-developed legal system.
3. In both the countries, the rights of shareholders, disclosure and transparency requirements are entrusted with the board as laid down by OECD principles of corporate governance (Alzahrani, 2013).	3. The members of the board are appointed by the wealthy families and the government because of the concentrated ownership. The shareholding in the UK is mostly well-spread and diversified providing for the chances of adoption of better corporate governance practices (Al-Ghamdi, 2015).
4. Corporate governance regulations and listing rules are found to be mostly common in both the UK and the KSA. Manipulation and insider trading are prohibited both in the UK and the KSA. The regulations regarding disclosure and transparency are mostly common among the UK and KSA jurisdictions providing for global standards of corporate governance, although there are differences in the matter of implementation of the best practices between the two countries (Alkahtani, 2015).	4. In the UK, proxy voting and use of technology tools appear to be common in the conduct of company meetings. These are entirely absent in the case of KSA companies.
5. Similarly, cumulative voting is still optional in the UK and KSA instead of being a mandatory mechanism for the protection of the rights of the minority shareholders.	5. CEO duality is a common norm in the case of KSA companies, which poses a significant impediment to the effectiveness of corporate governance practices.
	6. Implementation of the corporate governance practices are of recent origin in the KSA while UK has started following the practices since the 1990s.

4.2 The similarities & differences corporate governance in UK & KSA.

4.13 SUMMARY

Corporate governance offers regulations that reflect the efforts of regulators to integrate best practices into the business environment. The associated governance is beneficial to all corporations within a nation, both listed and non-listed firms, and the society as a whole. The primary goal of corporate governance is that of embedding best practice in all corporations within a nation, so that they can attract more investors. With transparency of business, comes investor confidence. The management, including directors, of an enterprise are also forced to become more disciplined when a country has good corporate governance. The non-listed companies in the stock market also benefit from corporate governance, elevating their levels of diligence and professionalism. This helps the managers and directors to align their interests with those of the company, so that the shareholders obtain the fullest value of their investments.

Chapter 5

DATA MEASUREMENT

5.1 INTRODUCTION

The present study intends to evaluate corporate governance practices' effect on value of firms in the UK as well as in the KSA in the 2010 - 2015 period. The study will particularly study how firm value and financial health are impacted by the board of directors, profitability, audit committee, leverage, and liquidity. Since this study uses the EPTM to assess the nature of the relationships between the selected independent and dependent variables, the sample and variables will be examined in this chapter. Therefore, the chapter is divided into the following four sections: sample, value variables, control values, and corporate governance variables.

5.2 SAMPLE

This section provides a description and breakdown of the companies that form the sample dataset for this research, and their respective sectors. The sample group comprises 26 firms from the Financial Times Stock Exchange (FTSE) 250 on the London Stock Exchange (LSE), and 30 firms from the Tadawul (Saudi Stock Market) resulting in a cohort of 56 companies that comprises the top firms in both stock exchanges, which were selected based on their market capitalisation¹¹. The sample size was sufficient to indicate generalised trends in terms of corporate governance and its likely effects.

The research covers a range of sectors, represented on the UK and the KSA stock markets (i.e. the FTSE 250 London Stock Exchange and the Tadawul). The study covers the period from 2010¹² to 2015. This time span was chosen because the study period is a critical aspect of all research work and using a time frame of six years allows the researcher to better understand the trends in corporate governance for the selected study area. The activities that have taken place within a period of six years yield clear insight into the variations and fluctuations of factors that affect corporate governance in both

¹¹ Market capitalisation is used because it captures the importance of the companies perceived by investors (Barrett, 1976).

¹²The Saudi government reformed the regulation of corporate governance in 2010.

the UK and the KSA. It also validates the research work, as the data used here is very recent, and thus is of more value than much older data

For the purposes of observing trends in the UK and the KSA corporate governance, it is useful to consider the companies studied in two categories, namely those companies that provide financial services, and those that operate in other sectors. Table 5.1 shows the company classification of enterprises in the two sectors both in the UK and in the KSA.

Country	Sector	No. of firms in each sector forming part off the study dataset	Percentage of business population sampled
UK	Companies providing financial services	6	23%
	Companies not providing financial services	20	77%
Totals		26	100%
KSA	Companies providing financial services	5	16.6%
	Companies not providing financial services	25	83.3%
Totals		30	100%

Table 5-1 Summary of sampled companies, categorised as those providing financial services and non-financial companies, in both the UK and KSA (source: Author)

The data utilised in this study is taken from the relevant company websites, which accurately reflect each company’s financial positions and trends in its value. The company websites also contain the annual reports that record the companies ’financial information. The use of the companies’ annual reports for this research was motivated by the assertion made by Fraser et al., 2006 that the information recorded in a company’s annual report is more accurate than data obtained from external sources. The company annual reports are therefore of paramount importance in offering quality and reliable information about, and an overview of, the company’s financial situation.

In Table 5.2, below, the populations of all enterprises in both the UK and the KSA stock exchange markets are listed. The chosen businesses that appear in Table 5-2 have been selected based on their size. This is because the size of a company is key to determining its participation in the capital markets, not only in the UK and/or KSA, but in any country. The selection of companies for this dataset was also based on the fact that they operate in various, different, sectors or industries. The financial services category comprises insurance companies, banks, real estate firms and all providers of the various other financial services. Meanwhile, the category of non-financial companies covers all other industrial and service companies¹³.

Country	Sector	Study population	Total Observation
UK	Mining	3	18
	Electricity	2	12
	Food	5	30
	Energy	5	30
	Transport	5	30
	Financial Services	3	18
	Banks	3	18
Totals (during the six years studied)		26	156
KSA	Petrochemical Industries	12	78
	Cement	5	30
	Transport	4	24
	Energy and Utilities	2	12
	Agriculture and Food	2	12
	Banks and Financial Services	5	30
Totals (during the six years studied)		30	180

Table 5.2 The study sample categorised and described by whole company population (source: Author)

¹³ The names of UK & KSA Companies are provided in Appendix C and D respectively.

The data given above was derived directly from each company's annual financial reports; this was done manually to ensure accuracy in data collection. All data entry was double-checked to minimise error and ensure accuracy. The data sources offered financial information, including summaries of the annual balance sheet, financial ratios, and income statements. The annual report sources also included the list of directors and the name of the companies that audits their corporations. The number of UK companies selected as a sample was 26, while for the KSA it was 30. This is an excellent representation, which provides an overview of corporate governance in the two economies.

The selection criteria for companies included in the sample required that they had never faced liquidation, either voluntary or obligatory. Also, the companies chosen had a clear record of operating as individual entities, rather than having been formed through acquisition or merger. Although the financial institutions operate under various rules and instructions, the study included them to facilitate a clear comparison with other companies, operating in different sectors. The unique nature of the statements issued by financial institutions makes them useful, because they provide well-standardised data concerning each company's financial position.

The previous studies that relate to this research have influenced the choice of sample size. The study by Cheng et al., 2008 determined the sample size for that study with a view to offering a solution for panel data analysis, for the enterprises that have sequential data spanning several years. Additionally, the most recent data in this study's sample dates from 2015, which is very recent and thus enhances validity. The use of data from a company's very recent past allows the research to generate a clear picture of the company, and to make reasonable predictions about its likely future. Indeed, the current position of any institution is gauged by the use of its recent performance data. These facts have led the researcher to establish a time span for the sample data, which is the period between 2010 and 2015. Furthermore, this term is also broad enough to show the correlation(s) between various variables that affect corporate governance.

The large companies that are listed on the stock exchange markets are good indicators of a country's economic performance. Thus, the researcher has sampled larger businesses, which have been operational in the London Stock Exchange and the Saudi Tadawul. Any poor performance by these enterprises is an indication that their corporate governance is questionable; the bodies that have the responsibility to ensure national economic stability must therefore act quickly to ensure the continuing smooth operation of the economy. The study of both financial and non-financial companies in this research allows the comparison of performance in different sectors, as these pertain to corporate governance issues.

5.3 VALUE VARIABLES

In the past, researchers such Adjaoud et al., 2007 have confirmed that the critical tool for use in examining the value of any organization is the application of diverse financial performance measurements of that particular organization. Tobin's Q (sometimes referred to as the Q ratio) is a key financial indicator, used in almost all studies (as has been documented in the literature review) along with return on assets (ROA), return on equity (ROE), return on investment (ROI) and the net profit margin ratio (NPM) Bauer et al.,2004. Noteworthy, these financial measures can be divided roughly into accounting-based measures and market-based measures, the chief distinction being that the former examine present financial performance, while the latter tend to focus on investor perceptions with respect to future firm value.

This study uses the Q ratio as a tool for examining the value of the companies selected for the sample dataset in this study. Tobin's Q ratio takes its name from the inventor of this formula, James Tobin, who derived this formula in 1977, when developing the hypothesis that the linked market value of all participating companies in the stock exchange is approximately equivalent to their replacement expense. Therefore, if any firm's market value is divided by that firm's assets' total value (that is, the firms' assets' replacement value), it determines Tobin's Q. According to (Chung and Pruitt, 1994, Beiner et al., 2006) this yields the following formula:

$$***Q Value = Market Value of the Firm / Total Value of the Company Assets***$$

It is very hard to obtain, or make an estimate of, the replacement costs of all business assets; thus another, alternative, formula that aims to establish the Q value of the company has been developed.

Tobin's Q is used because it is highly useful in illustrating the company value. When the value of the company is lower than one, the company continues to enjoy a generous market share, because the potential customers do not intend to create a similar product. Such a company will enjoy substantial interest, and thus its stock value will tend to increase, thereby increasing the Q ratio. Conversely, when the Q ratio of a company is of a value higher than one, the indication is that it will have a higher value than the replacement cost. This is likely to encourage the entry of other companies, who will produce similar goods or offer similar services to the public. This is likely to bring additional competition for the firm, as many new firms will come in to take a share of the high firm value.

Tobin's Q has been used as a measurement in this study because it explains many different business phenomena. This allows management to understand the cross-sectional variations that exist between investment and decisions made by the firm. Additionally, Tobin's Q value shows the relationship that exists between managerial equity ownership and company value, and demonstrates the link between managerial performance and gains from tender offers. It also shows the connection between investment opportunities and the responses from tender offers. From investors' point of view, the Q ratio remains a statistical tool that serves as a proxy for the company value.

The use of Tobin's Q as a tool for this study was also motivated by the fact that it can measure the efficacy of the firm's management in using company assets to create the value for the investors and shareholders. The core purpose of any business is to make significant profits for its investor, so this tool is critical, because it provides results that are vitally important to the investors. Although the Q ratio may not be the best value measurement tool, the fact that it offers outputs that are so important to the investors shows that it has significant value for this survey.

Just as scholars have identified so many value measures that show the value of the firm, several criticisms have emerged. According to Haniffa and Hudaib (2011), the lack of consensus between scholars affirms that measure is the best sign of a firm's financial performance/ value. To prove their argument, these two scholars have argued that all the measures identified have various strengths and weaknesses.

The return on assets (ROA) as a measure of a company's profit was cited in a study by Demsetz and Lehn (2015), where it was held to be more of a representation of all underlying parameters, via an illustration of the year after a fluctuation, than of return rates in the stock market. This is because the stock market recovery rates involve a more reflexive aspect of anticipated future developments, rather than encompassing the current conditions of the business. Other studies involving corporate governance have used the same concept (Klapper and Love, 2004; Haniffa and Hudaib, 2011).

The application of accounting-based measures fails to take into consideration the prospects of the enterprise's future performance, although they remain the most general indicators of the current performance of the business. Conversely, the market-based measures of company value involve many problems and challenges in the context of emerging markets, simply because the firms in that environment tend to use debt financing rather than equity financing. The valuation of a company's market share offers a reflection of market value, provided there is efficacy on the capital market (Gompers et al., 2013).

Black et al., 2006 claim that the way insiders and outsiders view corporate governance can differ significantly. For instance, the use of accounting-based performance measures ROA and ROE, relates mainly to the wealth-generating effects of the mechanisms for corporate governance as they relate to the firm's management (insiders). However, the measures that are market-based, like Tobin's Q, generate a representation of estimations of the structure of corporate governance as it applies to the investors (outsiders). According to Wulf (2007), all of the accounting-based measurements maintain a direct straight connection with the firm's business strategies and performance attained. For instance, about 80% of the studies that examine significant variables that affect the value of the company, have used the ROA and ROE accounting tools as the key variables for their studies.

5.4 CONTROL VARIABLES

The control variables in research studies are those elements that (the researcher ensures) remain unchanged throughout the study. This happens so that in the consistent state, the relationship between the other variables under investigation can be better understood. Control variables therefore ensure the efficiency and validity of the study design. They are contributing factors that are eliminated from the experimentation for a clear understanding of the relationship between the variables under investigation. The relationship between independent and dependent variables is most aptly examined in the presence of control measures, since the latter remain constant, and thus enable clear insights to be gained into the examined variables.

In this study, control variables have used to explain the firm performance/ value. Some studies such as (Morck et al., 1988; Yermack, 1996; Shin and Stulz, 2000; Daines et al., 2010 and Gompers et al., 2003; Black et al., 2006; Chenhall and Moers, 2007) used different control variables. As presented in Table 5.3 a set of control variables that used in this study (e.g., profitability, liquidity, leverage and financial health). The researcher thus acknowledges that the factors used in this survey do not indicate any limitation of the control variables for corporate governance studies. Since previous researchers have used many other control variables, both present and future researchers have a range of variables to choose from, too.

Control Variables
Profitability
Liquidity
Leverage
Financial Health

Table 5.3 Summary of control variables used in the present study. (Source: Author)

5.4.1 Profitability

The current situation facing the market is that of stiff competition, which tends to suppress the percentage value of a company's profits. This calls for the use of strategies that will give the business a competitive edge. The pressing need is to maximise profits, thus the company's financial planning must be integrated with all other corporate decisions, for improved value. The factors that are believed to define the profitability of a firm include sales, pricing strategies, expenditure and/or the cost of business operation. The success of the company is shown by the level of its profits. According to Kiyotaki and Moore (2012), the determinants of a company's profitability may vary from time to time. This makes profitability useful as the control variable. For instance, when the interest rate on loans is reduced significantly, the income emanating from loans is also reduced significantly, and this will be reflected in the form of lower profit levels over the relevant accounting period.

Statements of company income show the breakdown and detail of the revenues and expenses that the corporation has incurred for particular accounting period. The profitability may be measured using the profitability ratio, which offers an analysis of the financial health of the enterprise in that particular accounting period. The profitability ratio gives its measure by looking into the means by which profits were earned in relation to sales and assets of the company (McMurrian and Matulich, 2016). The profitability ratio shows the level of efficiency through which the company made use of the available resources to create value for those investing capital into the business.

This study has used profit margin and return on equity to measure the profitability of a company.

- ***Profit Margin (PM)***

Profit margin (PM) is one way to determine a firm's profitability and refers to the percentage of the revenue that remains following the deduction of expenses from sales. It can be calculated in the following way:

$$\text{Profit Margin} = \text{Net Income} / \text{Net Sales (Revenue)} \times 100$$

- ***Return on Equity (ROE)***

Return on Equity (ROE) is another way to determine firm profitability and determines how much profit a company produces based on a unit of shareholder equity. It can be calculated in the following way (where net income refers to sales following the deduction of expenses, and shareholders' equity refers to the book value [sometimes called net worth]). It can be calculated in the following way:

$$\text{Return on Equity} = \text{Net Income} / \text{Shareholder's Equity} \times 100$$

5.4.2 Liquidity

The term liquidity, in the finance discipline, signifies the degree to which a firm's assets can be exchanged in the stock market without this having any direct impact on the price of the asset. In the stock exchange markets in both the UK and the KSA, this rate varies for different participating companies. Therefore, there is need to define market liquidity, which is the extent to which the stock exchange market permits the sale and purchase of assets at stable prices. The study by Chamberlain and Gordon (2009) shows that liquidity plays a vital role in company survival. These authors further claim that its importance is rooted in the dynamics of sales, growth and the financial costs incurred by an organization. Another study, by Fang et al., 2009 asserts that liquidity reduces opportunism in/by the company's management by stimulating a business environment that uses informed investors hence investment decisions increases efficacy.

Connections have been made between company value and the liquidity ratio of the enterprise. This is because, through liquidity, the management can use internal liquidity to ensure the achievement of the company's short-term goals. When there is a need to deal with short-term financial distress in the company, liquidity is indeed a critical factor. Chamberlain and Gordon (2009); as well as Fang et al., 2009 affirm that the company's liquidity is extracted from the balance sheet of the firm this makes it a crucial factor for consideration when determining the financial health of the business. When a balance sheet is in the red, this indicates an operating loss. Thus, the firm must alter its priorities and its mode of operations, to bring itself into the black.

As noted by Kiyotaki and Moore (2012), when a firm's liquidity ratio is considerable, this means that it has a lower susceptibility to shocks, internal obligations and financial hardship. This means that the management can make use of the available resources for expenditure. The firm, therefore, does not need to borrow funds to pay its expenses. However Fang et al., 2009 have noted that very high levels of liquidity generate increased opportunity costs for a company, meaning that the firm is no longer in a position to make investment decisions on its profits so that it can generate returns on them. Therefore, managers need to maintain the liquidity ratio at a level that is neither too high no too low.

This study uses the cash ratio and the quick ratio to measure the liquidity of a company.

- ***Cash Ratio (CR)***

The assessment of liquidity of a company and its capacity for meeting its short-term obligations is the cash ratio (CR).

It can be calculated in the following way:

$$\text{Cash Ratio} = (\text{Cash} + \text{Cash Equivalents}) / \text{Current Liabilities}$$

- ***Quick Ratio (QR)***

The quick ratio is a short-term indicator of a firm's liquidity, which determines whether a firm can satisfy its short-term obligations. The QR can be calculated in the following way:

$$\text{Quick Ratio} = (\text{Current Assets} - \text{Inventories}) / \text{Current Liabilities}$$

5.4.3 Leverage

Leverage refers to a firm's ability to generate returns with a minimal cost of capital. Leverage in the context of financial management is a tactic encompassing the efficient utilization of borrowed funds in such a way that return on investment can be maximised. Leverage is concerned with employing debt and equity in a proper mix by the business entities (Rehman, 2013). The term leverage explains the relationship between the owned and borrowed funds of a firm that represents the capital structure of the firm. According to Barakat (2014), leverage is the technique of utilizing the funds belonging to a third party to the firm's advantage. Firms employ financial leverage with the idea of earning higher level of returns on fixed cost funds as compared to the cost of owned funds. The objective of financial leverage is to increase the return on the investments of shareholders which provides a clear tax advantage to the firm, when borrowed funds are employed as interest payable thereon is available as deductible expenditure for tax purposes. The decision on financial leverage is fundamental to any firm since the firms can maximise their returns on investments by employing a correct mix of debt and equity in financing their operations (Gill & Mathur, 2011). It is also possible that the use of financial leverage might lead to negative outcomes in cases of excessive use of borrowed funds. Most companies leverage their assets to lenders, so that they can obtain funding for expansion. This means their debts may be at low interest rates, compared to the returns that expansion brings to the company. Many researchers have argued that leverage brings both positive and negative implications for the business.

The relationship that exists between leverage and the firm value is well explained by the trade-off theory¹⁴. This theory indicates the existence of a capital structure for all companies, despite the fact that some leverage costs may be traded off through the merits of debt financing. Such costs are identified to include reduction of the equity agency cost and that of interest tax shields. Increasing the leverage of a company to the extent that the company's marginal gain from that particular leverage equals any expected marginal loss from the bankruptcy cost, will lead to an increase in the firm's value. It is at this point that the company's value is considered to be optimal. The value of a company increases with the increase in debt financing, but only up to a certain level,

¹⁴ The trade-off theory suggested by Myers (1984) confirms a balance between bankruptcy and financial distress costs and tax saving arising from debt, generates a decrease in agent cost.

at which point it is seen as optimal if the leverage is equal to the cost of bankruptcy for the company.

According to Black et al., 2006 the impact of leverage on the company value is dependent on management's monitoring of the company's operations. It is important to note that leverage plays a critical role in a company in that it helps to mitigate agency problems facing a company (Haniffa and Hudaib, 2011). This is because it is one of the most important corporate governance tools when it comes to cash flow challenges to companies. Bauer et al., 2004 argue that positive effects of leverage in a company may be evident when the management increases the external debts of the enterprise. This is because in that process the managers' discretionary ability is largely constrained.

This study has used debt to assets and debt to equity ratios to measure the leverage of a company.

- ***Debt to Assets Ratio***

The ratio of debt to assets illuminates the proportion of a firm's assets that are sustained using debt, as opposed to equity. It can be calculated in the following way:

$$\text{Debt to Assets} = \text{Total Liabilities} / \text{Total Assets}$$

- ***Debt to Equity Ratio***

Debt to equity ratio is used to determine a firm's financial leverage, and can be calculated in the following way:

$$\text{Debt to Equity Ratio} = \text{Total Liabilities} / \text{Shareholders' Equity}$$

When the debt to equity ratio is one, this signifies that financing in that company is equal for both investors and creditors. The value should be lower for stable businesses. When the value is higher than one, the business is at risk because most of its financing comes from creditors rather than investors. This is compounded by the detail that an increase of the company's leverage bars the company from raising new debts. Significant financial risk is associated with elevated leverage since this is likely to have an impact on stock value. Furthermore, when a firm has elevated leverage, this hinders business effectiveness owing to careful creditor monitoring and, furthermore, significant interest.

5.4.4 Financial Health

The financial health of a firm comprises its financial situation at a given time. The major areas that need examination when one is determining the financial health a company include its solvency, liquidity, operating efficacy and profitability. Financial ratios are critical in showing the relationship between various variables. Comparing the business assets and its liabilities allows one to understand the current financial position of that company, and it is through the financial health of a company that a firm attracts investment. Therefore, the financial health of a company is important to both internal and external players. The employees are motivated to hear that the firm is making profits because it reassures them of their job security. For investors, the financial health of an enterprise helps them to understand whether the company is capable of returning the investment capital. For the lenders, only the financial health of a firm tells them whether they are likely to get their money back.

Kapopoulos and Lazaretou (2007) argue that the various practices in corporate governance vary from one industry sector to another, depending on the capital structure that is needed to start a business in that industry. Other factors revealed in that study are the complexity of operating the business, and ownership levels. With many markets now emerging, there is a wide variation in the corporate governance standards across industries, and the survival of many firms now depends on the strategies that they apply to gain a competitive advantage over their rivals. Every strategic plan needs to have in mind the financial health of the business so that the company can reap the most from its market share.

In the present study, $Z - 1$ * Zmijewski score is used as the financial health score's proxy for understanding the financial condition of the sample companies that are included on the UK and the KSA stock markets (i.e. the FTSE 250 London Stock Exchange and the Tadawul). It determined a bankrupt firm when it requests a bankruptcy situation over a particular time period. It uses corporate financial performance as the benchmark against which the company's functioning in all aspects is measured, to generate a picture of the firm's financial viability. The Zmijewski score is employed as the proxy for a firm's financial health¹⁵. When Z score is analysed as a statistic determined it as: In state of

¹⁵ Numerous accounting research projects draw on the Zmijewski score to determine whether a firm is operating in the context of financial distress (Pava and Krausz, 1996; Ruiz-Barbadillo et al., 2004; Johnstone and Bedard, 2004; Carcello and Nagy, 2004). Given that the present study seeks to determine

firms with probability greater or equal than 0.5 are classified as bankrupt (Kleinert, 2014) .

The study has used this formula:

$$\mathbf{Z\ score = - 4.336 - 4.513 X1 + 5.679X2 - 0.004X3}$$

Where:

X1: Net Income To Total Assets Ratio

X2: Total Debt To Total Assets Ratio

X3: Current Assets To Current Debt Ratio

Managers are responsible for paying their company's current expenditure. Thus, it is essential to note that managers must have effective control over the enterprise's resources. The behaviour of executives dictates the direction that a company takes, because executives make many critical decisions on behalf the enterprise. Through tax shield computations, there is a positive relationship between the performance of a firm and the firm's leverage. The problem of under-investment is likely to have a negative impact on the company's value. There is a need to invest company resources into society because the company's effect upon society can have a major effect upon the company's ability to attract funding from potential investors.

5.5 CORPORATE GOVERNANCE

This section discusses the variables that are critical in influencing the corporate governance of a firm. Corporate governance uses four different scores to illustrate the variables covered by this study. These encompass features of the audit committee and the board of directors that will also be explored in this section.

5.5.1 Board of Directors

According to Bhagat Black (2002), a range of factors within and outside a company are highlighted in the academic studies of corporate governance as having an impact on the financial worth and functioning of a business. These factors include the constitution of the board, especially the number of members, its autonomy and the performance of the Chief Executive Officer (CEO), the role of senior managers, internal political issues as well as national politics and statutory requirements. According to Yung (2009), the board of directors is chosen by a given firm's shareholders, the purpose of the board being to resolve the issues its shareholders request (since shareholders cannot schedule frequent meetings). This is especially true if the number of shareholders is high. Monks and Minnow (1998) describe the board of directors as the interface between the shareholders and senior managers. The shareholders may be located anywhere on the globe and the board of directors provides a link between them and senior decision-makers based in the company's headquarters.

Hanrahan et al., (2001) argue that a significant function of the board of directors is to mediate between corporate governance and profits. The principal function of the board with regard to financial matters is to undertake its fiduciary duties. These include oversight of the decisions of managers and the recruitment of employees. According to Raheja (2005) and Adams and Ferriera (2007), the two most significant roles of the board are to monitor and advise. Furthermore, as Adams et al., 2008 have noted, the board is also responsible for selecting and having oversight of the operations of an independent auditor to defend the company's financial interests. According to Rossouw et al., (2002), the central obligation of the board is to maintain the interests of shareholders, but it is also the case, as noted by Brennan (2006), that boards should guarantee compliance and effective managerial practices. That can be achieved in different ways, including oversight of the activities of managers, especially their strategic decisions, providing guidance and leadership, ensuring the provision of adequate resources, surveillance and holding senior managers to account.

The principal functions of boards have been identified in earlier research as including the following: McNulty and Pettigrew (1999) focused on the function of boards in providing oversight of the company and their role in decision- and policy-making at a strategic level. Finkelstein and Hambrick (1996) commented on their importance in preserving a firm's reputation and compliance and Johnson et al., (1996) highlighted their task of obtaining resources for the company. Fama and Jensen (1983) have identified their role in validating the decisions taken by managers and ensuring their efficacy. Owing to the fiduciary obligations that the board of directors have to shareholders, their role in corporate governance affairs is considerable, and it relates to the supervision and evaluation of senior managers and the CEO. The role of boards is further enhanced by their involvement in the strategic decision-making of firms. Furthermore, Jensen (1993) and Brennan (2006) have stated that boards can only defend the interests of shareholders if they fulfil their functions competently. The number of members of a board, its make-up and diversity can all influence its ability to function competently. The purpose of the next sections is to examine the executive directors, board size, the frequency of board meetings, and non-executive directors with respect to the effect they have on firm value.

5.5.1.1 Executive Directors

Boards that include executive directors and non-executive directors are designated 2-tier boards.¹⁶ The executive directors carry the direct responsibility to manage the business and resources of the company. Numerous research projects have found that when several executives have positions on the board of directors, the firm's performance is typically more effective. As a case in point, Hutchinson (2005) indicated that investment opportunities become more positive when the board contains executives. The role of executives as directors has received recognition in view of the fact that such directors have a comprehensive understanding of the business of the company and hence are well suited to take decisions concerning the business of the firm (Nicholson and Kiel, 2007). However, according to agency theory, executive directors have a tendency to align their personal interests with the company's objectives, and to take decisions to achieve personal gains.

¹⁶ 1-Tier is a single board system, comprised of both non-executive and executive directors and directors (Jungmann, 2006). 2-tier is a dual board comprising a supervisory board and a management board that each act autonomously (Jungmann, 2006).

A key function of the board relates to monitoring, disciplinary issues, and the enhancement of managerial efficiency, thereby ensuring that managers can maximise the interests of shareholders.

Though a crucial source for the board for obtaining firm-specific information are the executive directors, as stated by Raheja (2005), the insider directors may pursue personal gains and the CEO may not demonstrate independence, leading to distorted objectives.

The executive directors' measure is determined by how many executive directors are present on the board.

5.5.1.2 Board Size

Board size is a measurement of the number of individuals who are members of a firm's board of directors. The core duties of the board or the council in a company are the monitoring of all business projects and the making of decisions about the succession of the company CEO. The board comprises members who operate both inside and outside the company. The directors of the enterprise understand the entirety of their firm's investment projects, as proposed by the CEO, and those from outside use CEO succession to give the insiders greater morale and to reveal critical information useful in decision making (Dalton et al., 1998). There have been empirical studies whose findings are mixed, as far as the relationship between the value of a firm, and the board size is concerned. Jensen (1986) records that a small board size contributes to the high performance of a company, when the agency cost is considered. Other studies have shown that an increase in board size will also lead to an increase in problems of coordination and communication. These problems will impede the smooth monitoring of management behaviour, and cause agency problems within the firm. The two studies thus have concluded that a small board size leads generates high value, yet others show that a small sized board brings problems to a company and may permit managers to pursue their own interests at the expense of the company.

Large boards require the CEO of the company to remain vigilant and control all of the board, rather than have the board control the management. This means that the company CEO must be given greater power, to perform this role effectively. Nevertheless, several studies, including (Dalton et al., 1998) and (Lehn et al., 2009), demonstrate that

increased board size corresponds to positive financial performance. This echoes the company resource dependence theory, which states that the large size of such a board creates external linkages. The board members will also have the chance to exchange ideas that when implemented, will contribute to the continued growth of the company.

As was previously noted, board size refers to the number of individuals on a firm's board. Some of the privileges that a company will enjoy when the size of the board is significant include enhanced access to new technologies, increased access to markets and even to raw materials. Large boards also play the critical role of enhancing the quality decisions, because they settle on decisions through consultation and voting (Lehn et al., 2009). This means that the decision settled upon are well thought of by every member of the board. These decisions are also based on the diversity of education, and the range of industry experience brought to the board by the many different members, which will lead to an elevated quality of advice to the CEO, which will in turn improve the performance of the firm. The range of conclusions reached in the previous studies on this variable makes the researcher unable to clarify whether a small or large size of board is best. However, in the interests of this research accomplishing its goals, it is notable that the companies' annual reports indicate that a good board, that will improve the value of a firm, should have between three and ten members (Bennedsen, et al., 2008). These board sizes are manageable, and their remuneration will be not a threat to company resources.

The total number of directors on the board is used as measure of board size

5.5.1.3 Board Meetings

The number of times a board meets in any given year can be regarded as an indicator of its efficacy. Persons (2006) suggests that if the board meets often, this may indicate how conscientious and attentive it is in fulfilling its function of oversight. According to Khanchel (2007), one aspect of effective corporate governance is the frequency with which the board is convened, and this is in line with agency theory. Vafeas (1999) argues that cost savings can be achieved if the regularity of board meetings is set effectively. Similarly, Xie et al., (2003) suggest that the engagement of the board, which is seen in the regularity with which it meets, affects its capacity to perform its function of oversight efficiently and to offset disputes within the company. Nelson et al., (2010) argue that the benefits of enhanced oversight include assurance that information is

received and understood, reduced outlay by the company and better performance. Shivdasani and Zenner (2004) have argued that board meetings ought to be improved in those cases where more supervision is required.

According to Conger et al., (1998), stakeholders believe that if boards meet more often, this can improve their efficacy and consequently their capacity to defend the interests of stakeholders, and this can then lead to a greater sharing of information. Shivdasani and Zenner (2004) have also suggested that more regular meetings of the board can improve communication and the sharing of information between directors. Laksmana (2008) has argued that an enhanced frequency of meetings facilitates a more efficient division of work and allocation of tasks to committees. This can, in turn, facilitate better decision-making by the board, and greater transparency. Furthermore, Laksmana (2008) states that there is a link between the frequency with which a board meets, and enhancement in corporate reporting.

Another benefit of an engaged board that meets frequently, is that it can spend a greater amount of time on matters relating to the environment and corporate social responsibility. It is evident from the above that the efficacy of a board is reduced if it does not meet frequently and, according to Demb and Neubauer (1992), its capacity to develop the strength of the company is thereby diminished.

The evidence indicates that more attention must be paid to the determinants of board effectiveness, and this includes meeting frequency (Van den et al., 2004). It has been demonstrated by Laksmana (2008) that more frequent board meetings can result in greater transparency this is an issue that had not been considered in previous research into environmental disclosure. Laksmana's (2008) study specifically shows the positive relationship between more regular board meetings and a willingness to reveal information about compensation. Conversely, research by Cormier et al. (2010) failed to demonstrate a link between board meetings and willingly revealing information relating to corporate governance. This finding is supported by Nelson et al., (2010) study of listed companies in Australia. Those scholars found only a statistically insignificant link between the type and quantity of mandatory executive stock option disclosures, and board meetings.

The board meeting's measure is determined by the attending numbers at the board meeting in a year.

5.5.1.4 Non-Executive Board Members

Many company boards have members who are not executives, where non-executives are those individuals who do not participate in decision-making at the day-to-day level of the firm's activities. They are, however, involved in policy making and the planning activities of the enterprise (Önel and Gansuwan 2012). These members bring balance among the board members. They are important to the company because of the roles that they undertake; these range from strategy, performance appraisal, risk control and the management of people. Non-executives can challenge the management and help in proposal development, which is geared towards improving the company's value.

The fact that the management usually makes decisions on behalf of the company can bring biases, especially when the managers have their own vested interests. The presence of non-executive directors on the board helps to assure objectivity in the board's decisions (Khan and Awan, 2012). Through the non-executive members, disagreements between managers are mediated by the non-executives to ensure smooth operation of the company. Non-executive board members also help to improve relationships not only internally, but also between management and other stakeholders.

The non-executive directors are in a better position to undertake the monitoring role more than the executive team is, due to their independence. For the present research, the measure of this variable is numerical, as this study uses the number of these members as the factor that will determine whether they affect the company value. Önel and Gansuwan (2012) hold that non-executives have sufficient independence that allows them to critically appraise and guide the executive team in a constructive manner. Non-executive members of the board are valuable safeguards against asymmetric information provision between executives and shareholders because they provide opinions that arise from engagement with all stakeholders. Ultimately, this has the potential to contribute to firm value, because it limits the potential severity of the agency problem.

The voices of the non-executive members can be heard if they are given independence when making their decisions. According to Hassan et al.,(2016), non-executives help in networking, and in the improvement of information flow both within and outside the company, which reduces uncertainty. The independence of these non-executive directors allows them to offer strategic advice that can protect the business' resources, without collusion with any stakeholder.

However, according to the theory of stewardship, the non-executive members function as part-time workers for a company. This undermines their ability to provide comprehensive monitoring and advice to the board because they themselves lack comprehensive information about what is happening within the firm. Their ability to offer informed decisions that improve the performance of the company is thus limited, according to the stewardship theory. Consequently, the managers, as insiders, hold the power to carry out the monitoring exercise and evaluate the business performance (Arosa et al., 2013).

Several studies have demonstrated a statistically significant relationship between firm value and the role of non-executive members of a firm's board of directors (Laing and McKnight., 2012; Gordini, 2012; Khan and Awan, 2012). It is notable that this issue has been considered in terms of the proportion of the board occupied by non-executives, where the proportion and its variance from company to company is indicated in annual reports.

The total number of non-executive directors on the board is used as measure of non- executive directors.

5.5.2 Audit Committee

The comprehensive and efficient reporting of financial information may improve the value of a company in the market. The work of the audit committee (AC) is therefore a matter of significant interest to stakeholders.

The functions of the AC have developed incrementally. From its origins as a voluntary form of oversight, which passed financial information on to stakeholders and was used only when a company was facing increased costs, it has now become a major element in corporate monitoring, and as such has started to receive greater attention from regulatory bodies and the general public. Today, the major functions of an AC, as set

out in the Sarbanes-Oxley Act 2002, Section 2, are to monitor the way in which a company performs its accounting, its auditing procedure and the manner in which it reports financial information. Abbott et al., 2002, argue that this implies the AC must comprise members with relevant qualifications, and that it should be engaged with stakeholders and impartial, in order to adequately protect matters of public interest.

As research studies have demonstrated, the AC's contribution in the domains of internal and external audit, the management of risk and the procedures for the reporting of financial data, is of fundamental importance. Consequently, an audit committee that operates efficiently can reduce disputes within a company, defend the interests of shareholders and so contribute to increasing the profitability of a company. An increasing number of the aspects of an audit committee that contribute to increased company value is now being identified in the burgeoning literature in this field.

The purpose of the audit committee is to supervise board activities, and to focus in particular on matters such as financial reporting, risk management frameworks and internal control systems. The AC meetings are held according to company provisions, but commonly it meets once in a year. Those companies listed on the London Stock Exchange market must have an AC containing two or three non-executive members. The presence of these independent parties improves the AC's to execute duties for the company. Companies on the Stock Exchange Market have a similar, directive, policy.

The importance of the AC meeting is to ensure integrity, professionalism and honesty in dealings with the enterprise's resources. The key attributes of the AC, according to the existing literature, will be further examined, and in particular their relationships with variables such as meeting frequency and size.

5.5.2.1 Frequency of Audit Committee Meetings

Meetings of the AC permit the monitoring of integrity, specifically with regards to the financial statements of the company, for it is during these meetings that the corporation's financial reports are revealed. Önel and Gansuwan (2012) suggest that it is important to note that the efficiency of this function can be enhanced if the AC's meetings are frequent. Therefore, this study measures this variable in terms of the number of meetings that a company's AC holds. A company that holds AC meetings frequently and reports on a quarterly basis, enhances its ability to keep management in

check and prevent their mishandling of the company's resources. Another important aspect of AC meetings is the control they can exert over the financial statements of the enterprise. It is through AC meetings that recommendations are made, concerning the board's decision to appoint or remove an auditor. This allows the company to ensure the clear reporting of finance resources to the company. During AC meetings, the instances of any missing cases, data errors and missing variables, etc. are reported, and the AC offers the way forward as far as disciplinary actions are concerned. During the AC's meetings, the auditor to the company presents the audit report that covers the entirety of projects that the firm has allocated funds to. This keeps the management in check, so that they do not misappropriate resources to serve their own interests.

Through the AC meetings, the managers are supposed to explain on any missing funds, and any disciplinary actions against them are progressed according to the relevant company policies. Thus, the AC brings transparency to the company's resource allocations, helping the company's value to increase. Frequently, an outcome of an AC meeting will be to prevent managers from spending business resource on activities that are unlikely to add value for the company's investors. This will tend to promote the company's value, since resources will reach the projects they are intended for.

In many of the companies sampled for this study, it is evident that the number of AC meetings held each year depends on sector or industry norms. Companies dealing with fast-moving products generally hold AC meetings more frequently than their counterparts in the banking and mining industries. This is because companies with rapid turnover of product will undertake many transactions within a short space of time, and that can create a loophole whereby managers use company money in other projects and return it when the audit meeting is approaching. As a result of this, it has become common for many corporations to hold AC meetings without notice, so that managers who are tempted to behave in this way can be more easily identified.

The number of audit committee meetings held in a year is used as measure of audit meeting.

5.5.2.2 Audit Committee Size

The term 'audit size' as it applies in the context of this study refers to the extent of experience that an auditing firm has, in the field of undertaking audits. The selection of auditor for a company may cause that company to look into the size and profile of that firm in terms of the clients it serves, which may (or may not) have an influence on how they will undertake the process of audit. The audit size affects corporate governance because it affects the incentives that the auditor can point to, to justify its being appointed (Yasser et al., 2017). Small audit firms may be discriminated against in the market, because potential clients may think they lack the appropriate experience. However, some managers may favour them, thinking smaller firms more likely to alter a breach so that they can retain the client involved. Of course, this is against the laws and ethics that govern auditors and the process of auditing.

Audit size is an important factor to consider, because an auditing firm that is larger in size will have many clients, and thus will never alter clients' reports because they have more than enough clients on their books. This study assumes that the size of the audit firm's experience does not matter, because the quality of the audit is the only relevant factor.

Regardless of the size of the auditing firm, its clients expect transparency in its work (Hassan et al., 2016). The job of the auditor is to thoroughly examine the company's assets, record the findings and make a report to the company's stakeholders about the business as a whole. When the quality of the auditor's report is good, and does not contain any 'alterations', it will reflect the true value of the firm. Ideally, this will allow all parties, both within and outside the company, to make informed decisions about making further investment in the company or withdrawing their investment from it.

The auditing of companies ensures transparency in the work of managers, who are entrusted with investors' money. In this study, the audit committee is used as a proxy for audit size, where the audit committee comprises board members who are sufficiently trusted by their colleagues to be afforded the role of supervising the firm's financial reporting. The AC may often disclose the financial position of the company to its investors, lenders and any interested party. There is thus a need to have independent members of the AC, so that the committee's work reflects the true picture of the

company finances. Some members of the committee are thus drawn from outside the management of the company, to ensure their independence.

The number of member on audit committee is used as measure of audit size.

5.6 SUMMARY

This chapter, which considers data and measurement, has described the relevant sample, value variables, control variables and the corporate governance variables. The sample used in this research is made up of 26 firms from the UK's stock exchange, and 30 firms from the KSA stock exchange. These companies belong to different economic sectors within the two countries. These sectors include the banking industry, agriculture, mining and transport. The data used in this research was obtained from the various companies' annual reports, from both the UK and the KSA. The study uses control variables of profitability, liquidity, leverage and financial health. Corporate governance is examined by assessing the impact that several variables (including executive directors, board size, board meeting, non-executive directors, the frequency of meetings and audit size) have on firm value.

Chapter 6

METHODOLOGY, A REVIEW OF SMART PLS AND PRELIMINARY RESULTS

6.1 INTRODUCTION

This chapter is concerned chiefly with philosophical paradigm and the methodology relevant to this study. It shows the ontological and epistemological considerations and discussing the philosophy of research and justifies positivism selection of this study. Next, provides information relate to inductive, deductive and abductive research approaches and explains why it chosen deductive. After that, given the methodological methods and the purpose for chosen the quantitative, along with the preliminary results employed for the evaluation of the research framework. An overview is given of the structural equation modelling (SEM) chosen for data analysis, and the rationale for selecting the Partial Least Squares (PLS) technique is presented. These techniques' preliminary results involved missing data's treatment that examined for descriptive, correlation, and outlier matrix analysis for which SPSS was used for screening and cleaning.

6.2 ONTOLOGICAL & EPISTEMOLOGICAL CONSIDERATIONS

According to Saunders et al. (2012), research is an orderly method of finding out things, which allows researchers to know more about the phenomenon they are studying. This definition, with its emphasis on strong organisation, makes it clear that specific research philosophies, strategies, methods and tools will provide research findings with validity. Saunders et al. (2012) assert that the methodology used to answer the research question is a crucial factor in meeting research objectives. Before setting out the reasons why this study employed a particular philosophical approach, strategy and methods, it is useful to consider ontology and epistemology - since they are the two major influences on how a researcher views the world and shape research philosophy (Adams et al., 2007).

6.2.1 Ontology

Ontology represents what researchers think about the existence and the characteristics of reality in the world they are examining. Saunders et al. (2012) note that ontology starts from the assumption that the real world contains knowledge which can be examined and tested. Ontology is subdivided into two categories: the objectivist and the subjectivist position. Objectivists assert that reality exists independently of social actors and is therefore external to society and cannot be modified or influenced by the researcher. Subjectivism takes the opposite point of view, and maintains that it is the social actors who are creating the perceptions of reality they are then going on to study (Adams et al., 2007). This study will be based on the objectivist viewpoint.

6.2.2 Epistemology

Epistemology is closely connected to ontology and focusses on the methods researchers can use to reach an in-depth understanding of the nature of reality - whereas ontology concentrates on the existence of reality. Johnson and Duberley (2000) point out that epistemology also considers the source of knowledge, and whether it is correct. Positive epistemology provides an explanation for the phenomena in the social world by determining the causal connections which exist between its parts. Anti-positivist epistemology, however, takes an opposing view and argues that all social phenomena can be understood through the perceptions and attitudes of the social actors who are playing a part in the phenomena (Saunders et al., 2012). This study sets out to investigate the impact of corporate governance practices on firm value. As a result, the study will adopt positive epistemology.

6.3 RESEARCH PHILOSOPHY

All research studies' foundation, as per Saunders et al. (2012), is based on the research philosophy and, depending on the nature of the research, the researcher can determine the optimum method of collecting and using data by understanding research philosophy. Further, Collis and Hussey (2013) stated that a researcher can also benefit from understanding the research philosophy as it can help in determining the best instruments for the research objectives. In order to understand the various philosophical concepts, as well as various methodological terms, Saunders et al (2012) developed the research "onion", which shows the different types of research philosophies, the related approaches, strategies, and methods available to carry out research in the field of

business (see Figure 6.1). Four types of research philosophy are included in the research “onion”: positivism, realism, interpretivism and pragmatism. These four research philosophies mirror the different types of knowledge that are most appropriate for the research within the specific field under investigation.

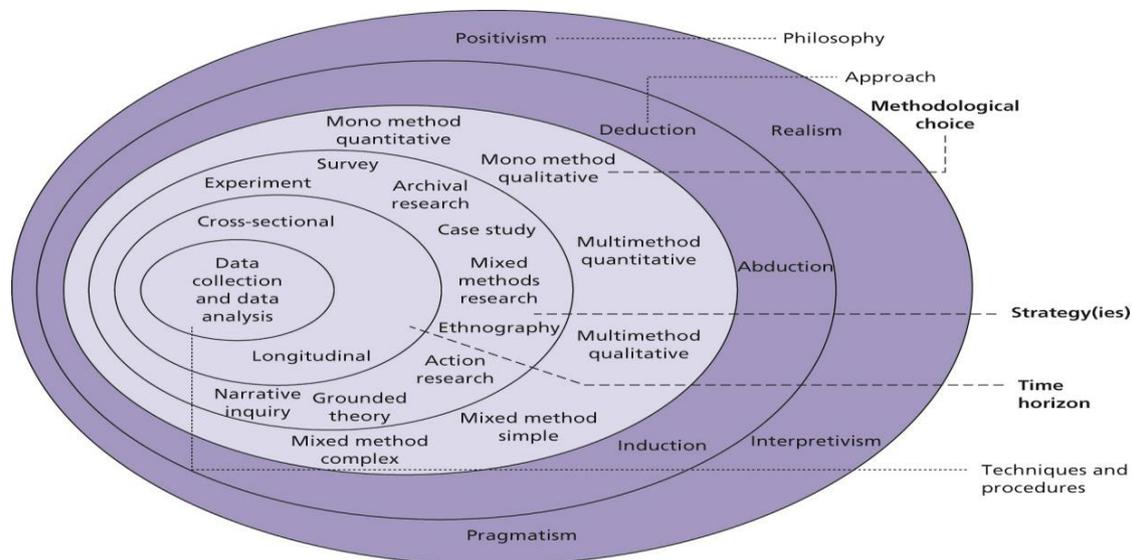


Figure 6.1: “The research ‘onion’ Saunders, et al. 2012”

6.3.1 Positivism

Saunders et al. (2012) explain that the positivist research philosophy supports research that involves an investigation of an independent social reality that is observable. That is, positivist researchers view reality as existing in an objective manner that means it can be measured or quantified without being influenced by a researcher (Collis & Hussey, 2013). The main goal of positivistic researchers is to discover the truth through the use of scientific style methods to generate knowledge in a systematic order. A positivist approach is usually reliant on quantification as a way of ensuring the accuracy and the credibility of research outcomes, and the data is discovered and presented using empirical methods (Johnson & Duberley, 2000). Research that uses this philosophical approach presents “law-like generalisations” that are similar to the research outcomes within natural sciences research (Saunders, et al., 2012).

Research that is positivist in nature focuses on the development and testing of hypotheses about the nature of the world. These hypotheses are tested by the researcher by collecting data from a representative sample of a larger population, and they are either accepted, modified, or rejected, based on the data collected, with the results generalised to the wider population (Saunders, et al., 2012). As stated by Adams et al.

(2007), highly structured methods are used by positivist researchers such that quantifiable observations as well as statistical analysis can be strongly focused on.

6.3.2 Realism

Realism is an epistemological position that has some similarities to positivism, as it also involves using a scientific approach to research and developing knowledge (Saunders, et al., 2012). Moreover, critical realism and direct realism are the two forms of realism. Sobh and Perry (2006) and Saunders et al. (2012) stated that in direct realism, the researchers' observations are their discovery, while in critical realism, the researcher considers the wider picture and not only the specific details.

6.3.3 Interpretivism

Interpretivism views reality as existing in multiple forms and as not being independent from social actors. The impact on the topic being researched from the researcher is acknowledged, and the researcher is seen as part of the social world, which can also undergo change (Saunders, et al., 2012). An interpretive approach posits that reality can only properly be researched and understood through subjective interpretation (Scotland, 2012). In other words, according to interpretivism, reality is socially constructed and it is not possible to study it entirely objectively or to for participants to be objective. This is due to the understanding that people's perceptions of their own lives and activities can be better understood by considering the impact of the social context on people's behaviour (Collis & Hussey, 2013). An interpretivist approach involves the collection and analyses of qualitative data to obtain knowledge. This approach is used in the social sciences as it is more appropriate for studying social and cultural phenomena than statistics. An inductive approach forms the basis of qualitative research, with the data collected and examined, and theories built on the results gleaned from an examination of that data (Power & Gendron, 2015).

6.3.4 Pragmatism

Pragmatism combines both positivism and interpretivism by utilising the viewpoints of both of these philosophies. Therefore, in order to answer the research questions, external or multiple views of reality can be examined. Using a pragmatist approach means that the research questions determine the most appropriate philosophy for underpinning the research and what is seen as acceptable knowledge (Saunders, et al., 2012). A pragmatist research philosophy posits that both positivism and interpretivism can be combined in a single research study according to the best way to collect and analyse data to answer the research questions. This suggests that the same research study can implement quantitative as well as qualitative data collection methods (Saunders, et al., 2012).

6.3.5 Selection of a Positivist Research Philosophy

Considering the nature of the problem being examined in this study, it uses a positivist approach. Moreover, the research is also guided by this and other related fields' reviewed literature. As stated by Aliyu, et al. (2014), a deductive process is used in a positivist approach for evaluating causality. For this, Cresswell (2014) states that hypotheses should be developed and the casual relationships existing between variables should be modelled using quantitative methods for testing the suggested hypotheses and relationships, that the researcher must maintain its independence from the research. A study is considered to be positivist, states William (2007), if it is founded on pre-determined relationships, tests hypotheses, uses quantifiable methods for measuring constructs, and uses a sample from a population for generalising the results to that population on a wider scale. Further, Ryan et al. (2002) and Chan et al. (2013) note that in a positivist approach, the analysis and investigation instruments generally include case studies, experiments, statistical analyses, and questionnaire surveys.

This study uses a positivist approach, since this is suited to investigating corporate governance practices in the UK and the KSA by examining firms' annual reports - an approach which will enable the observer to remain detached from the phenomenon which is being evaluated. Saunders et al. (2012) argue that positivism is more advantageous and useful if the type of problem needs to recognise and understand elements which impact on the outcome. This study will therefore take a positivist approach, since it sets out to investigate the impact of corporate governance practices

on both financial health and value of firms which are listed on the London Stock Exchange (LSE) and Saudi Stock Exchange (Tadawul).

6.4 RESEARCH APPROACH

Saunders et al., (2012) list three types of research approach: deduction, induction and abduction. Each approach is particularly effective when used with a specific philosophy: for example, deduction is well suited to positivism, and induction works well with interpretivism. The abductive approach can include both the deductive and inductive approaches, and fits a range of different philosophies.

6.4.1 Deduction

Saunders et al., (2012) state that deduction involves moving from theory, or the general, to data, or the particular. This study began by looking at learning theories and then proceeded to examine how gaming technology impacts on learners - and finally compared the effects of gaming technology and e-books, in terms of their impact on learners. There are a number of steps associated with deduction (Blaikie, 2010), namely: to determine the notion, premise and factors to examine the relationships between the concepts, and then move on to compose a theory. The next step is to use the literature review and theory to define factors, and test the factors and the original premise. The third step is to test both the premise and the arguments in the literature review which have generated variables and factors, before putting the results side by side with the theory and seeing if it creates unambiguous understanding. Once this is done, the researcher must look at the premise and factors, in order to measure and analyse them. Finally, if the researcher finds that the outcome is inconsistent with the research concepts, the test has failed. If the opposite is true, and the analysis results meet the theory concepts, the theory has been confirmed. Gill and Johnson (2010) make the point that when deduction is used alongside quantitative methodology, it is vital to have a large research sample and a well-structured methodology.

6.4.2. Induction

Saunders et al. (2012) define induction as the process of moving from data to theory, adding that induction is founded on gathering data about a particular phenomenon, to get a clear view of the problem. Analysing the data directs the researcher on the way to building a theory. As noted earlier, induction moves from data (the general) to the theory (the specific) and is used with qualitative research. Since it does not demand a strictly structured methodology, it can use a small sample for collecting data.

6.4.3 Abduction

Suddaby (2006) asserts that an abduction approach regularly moves between deduction and induction. Abduction observes, studies and monitors the fact of both phenomena by using the concepts gleaned from theories to test and observe the phenomena. Next, the findings are used to create a robust theory or model, which will correctly and precisely explain real phenomena or events.

This study adopts a deductive approach, because the study is informed by scientific principles and uses existing hypotheses. The findings are also extrapolated from quantitative data and rely on analytical procedures. The researcher relates variables rather than examine the context, a methodology that promotes the adoption of a deductive approach. A further reason for choosing the deductive approach for this study is the existence of a large sample size from which to generalise the result.

To underpin the research, the researcher performed some preliminary steps, which include the development of hypotheses related to the association of variables that is the basis of the study. The study clarifies these hypotheses, which will be analysed, and explains the measurement of variables.

To illustrate the impact of corporate governance on firm value, a specific research strategy is adopted by the researcher, which related to the aforementioned hypotheses. An experimental research strategy is used to analyse the relationships among the variables. Hair et al., (2012) define experimental strategy as the true experiment that manipulates a variable at a given time and randomises the remaining variables accordingly.

By drawing on data analysis techniques, this study seeks to generate reliable and valid responses to the research questions, thus illuminating the relationship between corporate governance practices in UK and KSA firms and their financial health, as well as firm value. This study draws on the deductive approach, since it relies on hypothesis formation and testing, and it relies on the positivist philosophical paradigm to generate objective and knowledge that can be generalised. Ultimately, as has been noted by Hussey and Hussey (2009) and Saunders et al., (2012), it is important to remember that research objectives can never be achieved successfully in cases where the research design is not appropriate.

6.5 RESEARCH METHODOLOGY

Saunders et al., (2012) note that there are three main research methods: quantitative, qualitative and mixed methods, and that each is suitable for a particular type of research.

6.5.1 Quantitative

Quantitative research methodology focuses on measuring numerical data and examines the link between research variables. Data is analysed by using statistical tools (Saunders et al., 2012). Dawson (2013) and Pickard (2013) add that this research method is based on a framework derived from a literature review, and it is this literature review which assists the researcher to choose aims and objectives and create research hypotheses. Generally, quantitative research tests theories by using a positivist, deductive approach. Saunders et al., (2012) state that this research method can also take an inductive approach when constructing a theory.

6.5.2 Qualitative

Dawson (2013) states that qualitative research is used to examine behaviour, views and experiences by gathering data through interviews and focus groups. Saunders et al., (2012) assert that qualitative research methods focus on an in-depth evaluation of what participants believe, feel and have experienced, by using a range of data collection methods and analytical processes, on the basis of which a framework is constructed. The authors add that qualitative research uses an inductive approach and interpretivism, in order to build a theory or a model.

6.5.3 Mixed Methods

As the term implies, mixed methods approaches include both quantitative and qualitative methodology, in order to come to an accurate understanding of research hypotheses and investigation (Creswell, 2007; Creswell & Clark, 2011; Saunders et al., 2012). In addition, since the mixed methods approach seeks to gather both quantitative and qualitative data, it necessarily has to use a number of data collection techniques (Creswell, 2011; Saunders et al., 2012).

Clarke (1998) states that corporate governance research tends to use quantitative, qualitative and mixed methods. This study will use quantitative methodology because, corporate governance research predominantly uses the quantitative method (Cai and Tylecote, 2008; McNulty et al., 2013). This becomes evident when looking at studies on the precursors of corporate governance compliance and disclosure practices (Elshandidy and Neri, 2015; Hassanein and Hussainey, 2015; Hussainey and Al-Najjar, 2012; Mallin and Ow-Yong, 2012; Ntim et al., 2012a; Ntim et al., 2012b); and the impact on firm value/performance (Connelly et al., 2012; Leung et al., 2014; Müller, 2014; Ntim, 2015; Pandey et al., 2015; Terjesen et al., 2015). The above cited work used chiefly quantitative data.

This study aims to produce findings which are both valid and reliable (Collis and Hussey, 2014) and will therefore use statistical analysis methods. Neither qualitative or mixed methods approaches are not suitable for the purposes of this study, since it is difficult to gather objective data on the effectiveness of corporate governance practices, and the influence on the firm value. Collis and Hussey (2014) and Saunders et al., (2012) agree that positivist researchers should use data-based surveys to answer their research study's questions, and this study will thus base its conclusions on the quantitative data it collects during the research process. The ETPM theory is based on empirical findings, whereby the researcher uses the positivist understanding to conduct the research methodology process (Ardalan, 2012).

6.6 INTRODUCTION TO THE STRUCTURAL EQUATION MODEL (SEM)

The SEM method support social and behavioural science studies over the past decades and considered as the efficient tool for statistical development (Hair et al., 2014, Reinartz et al., 2009). The SEM is a powerful technique that combines complex path models with latent constructs (Ardalan, 2012). It is considered as a credible explanation to relate the variables when two matrices are consistent with each other. It easily interprets the complex data and relationship among the variables as well as overcome measurement errors occurs in the co-efficient (Hair et al., 2014). In another words, SEM obtains unbiased estimates between the latent constructs. Construct can neither be observed directly more measured directly, so to measure a latent construct researcher capture indicators. For this, SEM allows multiple measures to associate with a single latent construct (Urbach and Ahlemann, 2010). Furthermore, SEM enables researchers to interpret complex dependence relationship on the theoretical level. According to Hair et al., (2012), there are two interrelated models of SEM which includes the inner that is (structural) and outer that is (measurement) model (See Figure 6.2). Additionally Reinartz et al., (2009) defines the ability of SEM for accessing latent variables and tested the relationship between latent variables on the observation level and theoretical level respectively. The inner model examines the relationships (paths) between the dependences and independence variables which are called constructs, while the outer model examines the relationships between the constructs and their indicators (Tenenhaus et al., 2005). In addition to this, SEM also helps to evaluate the measurement model to interrelate the causality among variables (Hair et al., 2012).

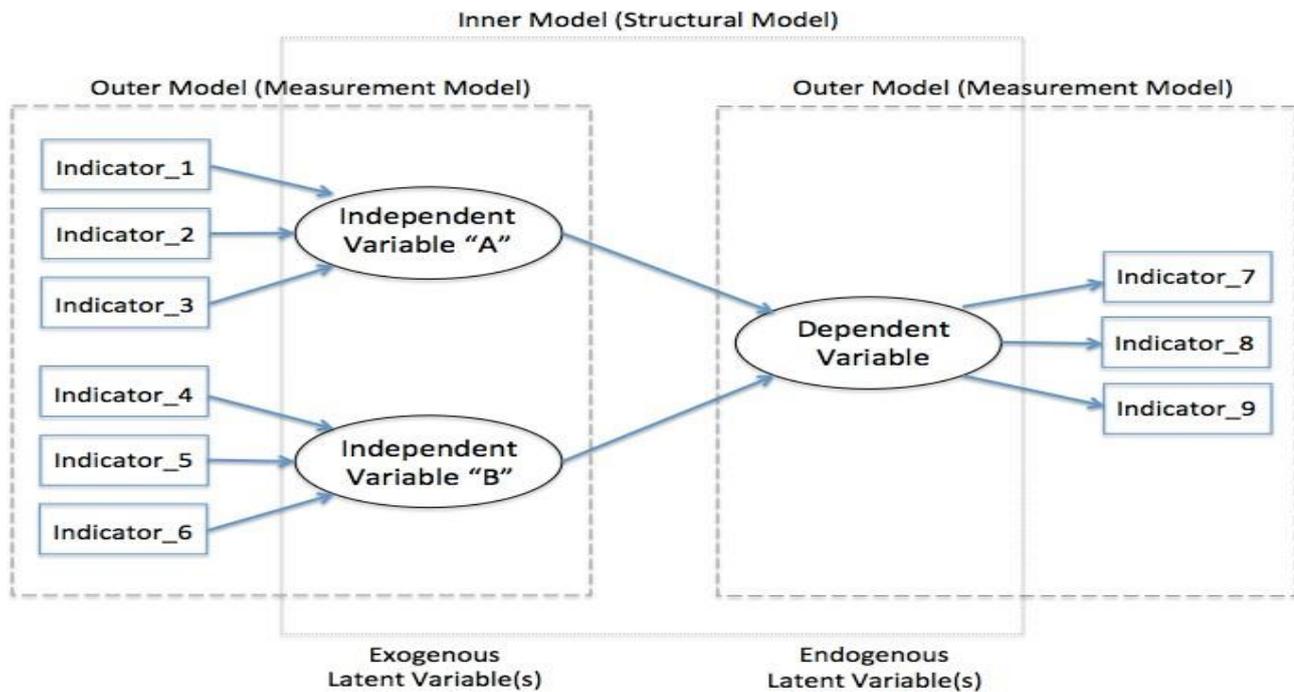


Figure 6.2 "Path model Source: Hair et al., (2012)"

There are two types of methods associated with SEM, which are covariance-based methods (CB-SEM), and component based or Partial Least Squares (PLS-SEM) methods. CB-SEM methods are popular among several disciplines, and a range of software programs are available, for example LISREL and AMOS (Chin, 1998b). However, there are sometimes difficulties meeting the requirements of CB-SEM, such as data normality, having enough cases, and providing reflective indicators. Furthermore, CB-SEM is not appropriate for small data samples and may even lead to incorrect conclusions (Chin and Newsted, 1999 cited in Ramli, 2013, p.99).

Partial Least Squares (PLS) addresses some of the limitations of CB-SEM. It provides a distribution-free approach through a two-step method involving a measurement model and a structural model (Tenenhaus 2008). LISREL is the most commonly used causal modelling technique, along with PLS (Ramli, 2013).

Chin (1998) explains that a major advantage of SEM and statistical techniques such as PLS, in comparison to Lisrel and Amos, is the flexibility it allows, such as multiple predictor and criterion variables and the relationships that can be modelled; the unobservable latent variables (LV) that can be constructed, and the modelling of errors in measurement for observed variables. In addition, theoretical and measurement assumptions can be made against empirical data, including the statistical testing of

confirmatory analysis (Byrne, 2006). In table 6.1 shows the characteristics of the PLS-SEM approach and compares it with CB-SEM, adapted from Chin and Newsted (1999).

Feature	CB-SEM	PLS-SEM
Assumption	Multi-variant and normal distribution along with observations that are independent	Specification of predictors
Approach	Covariance based	Variance based
Scores of variable latency	Indeterminate	Estimated explicitly
Estimation of parameters	Highly coherent and consistent	Consistent as sample size and indicators increase in number
Objective	Parameter oriented	Prediction oriented
Strong relationship between an LV and its measures	Only through the means of reflective models	Could be created across either reflective or formative models of measurement
Implications	This would be beneficial for parameter accuracy	This would be beneficial for accuracy parameter
Sample size	Ideally based on power analysis specific model Minimal recommendations	The concept of power analysis based on the model portion along with the most comprehensive number of predictors. Minimal recommendations would range primarily from 30 to 300 cases
Model complexity	Complexity ranges from small to medium	Largely complicated

Table 6.1: Comparison of CB-SEM and PLS-SEM

6.6.1 An Overview of PLS-SEM Procedures

According to Wold, (1985) structural equation modelling was used in partial least squares based on component analysis. Introduced in 1979, it was reformed in 1985, and since then there has been substantial research on the formation, application and potential advancement of PLS-SEM (Chin and Newsted, 1999; Lohmöller, 1989).

6.6.1.1 Model Evaluation

When evaluating the structural model, the researcher must select one of the available methods there are various approaches to modelling. The primary model is founded on the following stages: (i) stage one, which involves the evaluation of every measurement made to create the final model; and (ii) stage two, which involves the assessment of the structural model, as well as the measurement modelling. Table 6.2 provides an overview of every consideration that should be incorporated into the validation of the measurement and the structural models.

Stage 1- Evaluation of the Measurement Models	
Reflective Measurement Model	Formative Measurement Model
<ul style="list-style-type: none"> • Discriminant Validity • Indicator Reliability • Convergent Validity (indicator reliability & Average Variance Extracted [AVE]) • Internal Consistency (Cronbach's Alpha & Composite Reliability) 	<ul style="list-style-type: none"> • Collinearity Amid Indicators • Convergent Validity • Outer Weights' Relevance & Importance
Stage 2- Evaluation of the Structural Model	
<ul style="list-style-type: none"> • Coefficient of Determination (R^2) • Path Coefficients & Bootstrapping • Effect Size (f^2) 	

Table 6.2 the Process of Evaluation Assessing the Measurement the Structure Model Source: Hair, et al. (2017)

6.6.1.1.1 Assessment of Reflective Measurement Models

Reflective measurement model evaluation is one of the assessment techniques used in the application of partial least squares. The assessment reveals how dependent and independent variables are related to one another. Figure 6.3 illustrates this, and the arrows move from the factor to the indicator variables, signifying the underlying one-dimensional influence that comes from the variables to the factor. Such a reflective measurement model evaluation shows the relationship that exists between the independent variables and the factor under investigation.

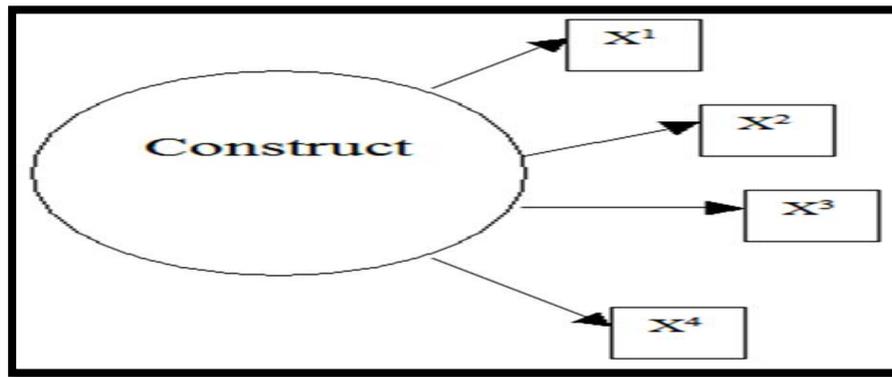


Figure 6.3 Reflective Measurement Model

According to Gerbing and Anderson (1988), some specific types of measurement, such as temperature, extraversion or reading ability, are measured unidimensionally. The variables of unidimensionality cannot be observed directly, they relate to each other in a way comparable to any other observed variable. For the purpose of measuring latent variables, it is possible to capitalise on Exploratory Factor Analysis (EFA), which facilitates the reduction of the data and the intersection of the target variables. According to Gefen and Straub (2005), item loading should be high, and when it exceeds 0.6 with a loading value of less than 0.4, this is referred to as a less value.

According to Henseler (2010), Composite Reliability (CR), along with Cronbach's Alpha (CA), is a useful way in which to determine the reliability of internal variables. Composite reliability represents different loadings of indicators. Henseler (2010) argues that Cronbach's Alpha allows the indicators to be measured equally according to PLS-SEM and acts to reduce the internal consistency reliability of unobserved variables. However, early stage research returned a reliability value of approximately 0.7, yet the acceptable value is at least 0.8, and an unacceptable value is lower than 0.6 (Nunnally and Bernstein, 1994), while CA value of 0.7 and above refers an acceptable reliability level (Cronbach, 1951; Pallant, 2010).

The measurement of quantity of difference found in indicators can be measured by indicator reliability. This is carried out through monitoring of the loading of particular indicators. Researchers have observed around 50 percent of difference found in an indicator. Similarly, Chin (2010) considered the value of indicator loading as being a minimum 0.5% or more than 0.7%.

Convergent validity is the calculation of the formulated parameters' load individual variables. Moreover, as suggested by Fornell and Larcker in 1981 (Haenlein & Kaplan, 2004; Vinzi, et al., 2010). Convergent validity can be calculated by average variance extracted (AVE). A satisfactory convergent validity is indicated by the minimum value of 0.5, which further clarifies the possible AVE difference existing between indicators.

Another validation, known as discriminant validity, also examines the surety of a construct measurement, that is, whether it represents construct variance or not. Discriminant validity testing, as stated by Hair et al (2010), is the determination of whether a construct's indicators represent its variance. Thus, in discriminant validity, it is ensured that phenomena of interest that is not captured by a structural equation model's other measures is empirically represented by a construct measure. Discriminant validity can be tested by three techniques that will be explained in the following section: Fornell-Larcker criterion, Cross-Loadings and Heterotrait-monotrait ratio of correlations (HTMT).

- *Fornell-Larcker Criterion*

For achieving discriminant validity, a higher AVE value is required than other related factors available in the model, and this is explained in the Fornell-Larcker criterion. This model, established by Fornell and Larcker (1981), more strongly emphasises the differences in shares of variables as compared to other formulations. However, the Fornell-Larcker criterion has been seen to fail in many situations. In view of this, Henseler et al., (2015) noted that discriminant validity should be employed for the purpose of eliminating the limitations of the Fornell-Larcker criterion. Furthermore, when attempting to test discriminant validity, it was not possible for the researcher to find methodological studies that verified the capabilities of the Fornell-Larcker criterion.

- *Cross Loading*

Following the unsatisfactory results generated by the Fornell-Larcker criterion, Henseler et al., (2015). Gefen and Straub (2005) stated that when every measurement item has a weak correlation with every construct apart from the one that it theoretically associates with, it indicates discriminant validity. Similarly, Götz et al., (2010) argue that the discriminant validity indicates the higher measurement when compared to cross loading values. The accepted level of item loading is supposed as 0.70, where the cut-

off value is acceptable by 0.50. Similarly, Chin (2010) claimed the most accepted value of item loading that is 0.40, which involves in the studies for measuring development.

- *Heterotrait-monotrait ratio of correlations (HTMT)*

Henseler et al., (2015) proposed another criterion by which to measure discriminant validity, and this is known as the heterotrait-monotrait ratio of correlation (HTMT). This ratio was, essentially, developed to enhance the capability of studies using the Monte Carlo simulation method when, in the context of a Monte Carlo stimulation study, Henseler et al.,(2015) analysed cross loading measurement and the Fornell-Larcker criterion of. In the view of Campbell and Fiske (1959), HTMT is obtained from the traditional methods and traits of a matrix, called the multitrait-multimethod (MTMM) matrix. As mentioned in Henseler et al., (2015), this approach relates the constructs ξ_i and ξ_j . HTMT allows researchers to compare and analyse item loading without any factor, and to construct the figures and scores without any calculation. Correlation is deemed satisfactory (i.e. discriminant validity has been achieved) when the value of Heterotrait-monotrait ratio of correlation is less than 1, and both constructs differ from each other. Conversely, when the ratio number is greater than 1, discriminant validity has not been achieved. Several researchers have suggested various alternative threshold values, e.g. of 0.90 or 0.85 (Kline, 2011).

6.6.1.1.2 Assessment of Formative Measurement Models

In a model intended to measure the formative variables, the arrows on the model diagram end at the factors from where they started at the indicator variables. A formative measurement model occurs when the measured variables are considered to be the cause of the latent variable and Figure 6.4 illustrates this, and the arrows move from the indicator variables to the factor. In a model description of this type, this indicates that the model incorporates a composite design variable that reflects and signifies the symbols representing the factor dimensions. That in turn implies that redundancy and communality might be unusually low, since none of the geometric links from the various dimensions will predict any other side. Therefore, the measurement of fitness in formative models demands a different form of assessment.

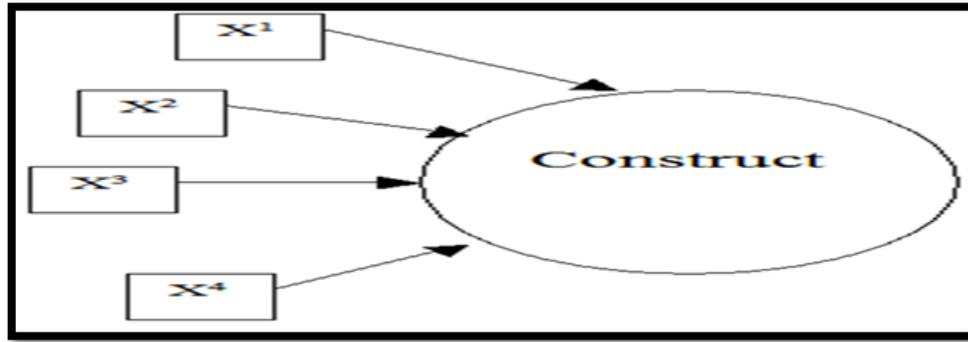


Figure 6.4 Formative measurement model

Various approaches are applicable for the affirmation of formative measurement models. Construct and indicators are the two levels that must be measured to ascertain the strength of formative construct figures. Henseler (2010) suggests that to measure the level of indicator, the observer is allowed to detect the importance of indicator by jackknifing, as well as by bootstrapping. A satisfactory value for an accurate result is considered to be 0.05, it is valid as formative index as well as assumed sufficient validity level. Additionally, the calculation of differences in inflation factor is the cause of change in multicollinearity between indicators of formative model (Cassel and Hackl, 2000; Fornell and Bookstein, 1982). On the same construct, the variance inflation factor (VIF) helps to indicate the quantity of one indicator as compared to other; however, as explained in Diamantopoulos and Sigauw (2006) and Gujarati (2003), there is no effect of threshold value if multicollinearity is less than 10. The possibility to measure or access level of construct is the test of desired strength with respect to nomology. In this context, nomological validity refers to the expected behaviour of the construct considered in the hypothesis (Henseler et al., 2009; Diamantopoulos and Riefler, 2011). As a result, a significant and strong relationship is found between the above studied models and the formulative model of construct. Moreover, according to Bruhn et al., (2008), the varied value is obtained if the correlation between all models is noted to be less than 0.7.

6.6.1.2 Evaluating the PLS-SEM Structural Model

After confirming the validity and reliability regarding the measurement model, the structural model must be examined. This involves examining the degree to which the model has predictive power, as well as conducting an evaluation of the construct relationships. In the context of the PLS technique, evaluating the structural model means that effect sizes should be examined, and this can take place following the evaluation of the measurement model.

6.6.1.2.1 Coefficient of Determination (R^2)

In almost all cases, the R^2 (also referred to as R-squared) value is employed for the purpose of assessing the structural model. The value range measures the predictive accuracy of the model and calculates the squared correlation between predictive values and a definite endogenous construct's actual value (Haier et al., 2014). The combined efforts of endogenous latent variable and exogenous latent variable are represented by the R-squared value. The exogenous constructs linked to it explains the extent of variance in the endogenous constructs, because of the squared correlation of predictive values and actual values. The range of R^2 is between 0 and 1, where 1 demonstrates high level of predictive accuracy. The R-squared value depends on research discipline and the complexity of the model, so there is no threshold value for accepting it (Götz et al., 2010). For example, in some cases if the value shows 0.20, it is assumed to be high in contexts such as in analysis of a comparison between consumers' behaviour and an elaboration of customer satisfaction, which has a range of 0.75. As has been noted by Henseler et al. (2009), and reiterated by Hair et al., (2014), an R^2 value of 0.75 is considerable, while values of 0.50 and 0.25 are moderate and weak, respectively.

6.6.1.2.2 Effect Size (f^2)

The value of R-squared is also helpful in analysing the effect of the exogenous construct over endogenous constructs. If a specified exogenous construct is deleted from value, the resultant change in the R-squared value is used to find out whether endogenous constructs have any substantive impact, in light of the deleted exogenous construct.

It is necessary to follow guidelines such as the ones by Cohen (1982) when evaluating the impact size, wherein the f^2 values of 0.02, 0.15, and 0.35 relate, respectively, to small, medium, and large. These, as stated by Hair et al., (2014) illustrate the impact of the latent and exogenous variable.

6.6.1.2.3 Path Coefficients & Bootstrapping

With regard to the structural model, the predicted path relationship is the path coefficient, (namely, in between the latent variable) (Hair et al., 2014). These bear some resemblance to standardised beta values in the context of regression analyses. Hair et al., (2014) suggested that, in order to analyse the importance of the path coefficients to find p and t values, bootstrapping can be used. Urbach and Ahlemann (2010) mentioned that there are no guidelines formally established, but that the firmness of the significance should be a minimum of 0.50 and relationship should be at least 0.10. In its evaluation, PLS depends on the non-parametric re-sampling technique, and does not require the data distribution used normally. The bootstrapping technique can be used to generate confidence intervals via t values. In bootstrapping, before the next observation is made a huge number of bootstrap samples are obtained from the original database. In every bootstrap sample, an equal number of cases are present, just as in the original dataset. Based on the guidelines generated by research, 5,000 bootstrap samples ought to be gathered (Hair et al., 2014), and these recommendations have been widely conformed to.

6.6.1.3 Mediation Test

As noted by Ramayah et al., (2011), a mediation test is a valuable way in which to determine the impact that a ‘mediator construct’ has on the correlation between an independent and a dependent variable. Furthermore, a range of methods can be used for the mediation test in multivariate analysis (Hayes and Preacher, 2010). These include simple methods such as the causal steps approach advocated by Baron and Kenny (1986) and the Sobel Test (cf. Sobel, 1982). Alternatively, there are more recent methods that require a lower number of statistical suppositions, although these may prove to be unreliable. Such methods include the distribution of the product approach described by MacKinnon et al., (2004), bootstrapping and other methods that involve re-sampling. These methods are discussed in Bollen and Stine (1990). Preacher and Hayes (2004, 2008) and Shrout and Bolger (2002). In the present study, the mediation

test used was derived from the partial least squares (PLS) method. The hypotheses were subjected to Wold's (1985) structural equations modelling (SEM) technique. Furthermore, the mediation test was evaluated through bootstrapping and re-sampling 5000 analysis to test the study hypotheses. Additionally, as Kock (2013) has proposed, the median of paths 'a' and 'b' were multiplied and then divided by the standard error indices of the paths in order to evaluate the mediation.

6.6.2 Justification for Applying PLS

Structural Equation Modelling (SEM) has been used in this study, as it is one of the most reliable and popular methods used for data analysis. It has been used to explain the relationships between various variables through an examination of the structure of interrelationships in a series of equations; in this way, it is similar to a series of multiple regression equations. Furthermore, it allows the theory and measure to be simultaneously evaluated. As noted by Fornell (1982), SEM can allow a variable to be both dependent and independent, because of which it hold an advantage compared to other traditional techniques by enabling measurement error to be explicitly included and incorporating the unobservable and abstract constructs.

The main theoretical perspective of this research study is the ETPM, as three distinctive theories are being tested; therefore, SEM is being used because it is convenient for theory testing, as opposed to theory development, as it utilises confirmatory modelling. Byrne (2006) and Gefen et al., (2000) (cited in Ramli, 2013) claim that for SEM, it is necessary to start with a hypothesis based on a thorough review of the academic literature, followed by developing a specific model. Next, the constructs of interest are operationalized using a measurement instrument before the final testing of the model.

The previous sections have explained why the use of PLS is helpful in this study, in particular, this is because the research focuses on the appropriate financial behaviour of companies. Thus, for this study, the suitability of PLS is primarily because the software is forecast based. The measures and constructs were initially created in a highly contemplative and formative manner, primarily via the ETPM. CB-SEM primarily works by means of formative measures, while PLS focuses on both the reflective and the formative.

The PLS method is effective with small sized data samples; in contrast, CB-SEM is best used with a sample size of around 200. The nature of the study also plays a role: due to the extent of research involved, conventional data allocation can become cumbersome. PLS can be effectively used with data that may not have a conventional distribution, while CB-SEM is better suited to conventionally distributed data. For this research, SmartPLS 3.0 software has been used and Table 6.3 below lists the studies that support the use of the PLS method the current study.

Author	Date	Rationale for PLS use
Acodo and Jones	2007	If variables do not adhere to normality distributions and if there is insufficient grounds for the theory, PLS techniques are helpful (p.242)
Ainuddin, Beamish, Hulland, and Rouse)	2007	In case of exploratory studies, PLS is helpful
Alpert, Kamins, Sakano, Onzo, and Graham	2001	In case of formative indicators, PLS techniques can be helpful as they offer a significant advantage compared to techniques such as LISREL (p.177–178)
Birkinshaw, Morrison, and Hulland	1995	In case of small sample sizes, PLS can be helpful (pp.646–647)
Calantone, Graham, and Mintu-Wimsatt	1998	Regarding direction and strength, PLS offers distinct parameter estimates
Festge and Schwaiger	2007	In case of the researcher focusing on place and not on endogenous construct, PLS can be helpful (p.192)
Graham, Mintu ,andRodgers.	1994	PLS offers flexibility with no requirements for following specific normality measurements (p.80)
Green and Ryans	1990	PLS has considerable flexibility and tolerance towards positively skewed data distribution
Holzmu' ller and Kasper	1991	In case of predictive purposes, PLS can be flexible as well as reliable

Source: Henseler, Ringle, and Sinkovics, (2009, p.279)

6.7 PREPARING & EXAMINING DATA

Data preparation and examination are crucial, and in this study, IBM-SPSS v.22 has been employed to examine the data using PLS-SEM. The purpose of this section is to describe the data, to identify missing data, and to outline how anomalous results are addressed.

6.7.1 Missing Data

Missing data in statistical studies occurs when the data value of the variable is not stored in an observation. Most research projects have missing data, but this does not mean that the severe impact this has on the results (including biased parameter estimates, impaired statistical power, higher standard errors and hindered generalisability) should be overlooked. According to Murphy and Tresp (2006) and Richter (2008), around 3%, 5% or 10% of data may be excluded from the analysis.

In this study, wherever there is an absolute 0 (not any approximation; all decimals are kept in the analysis) in any observation cell, it is taken to be missing data. As shown in Table 6.4, below, in the current study the missing data method leads to 32 missing values for the UK (1.5% of total observations) and to 68 missing data points for the KSA (2.6% of total observations). As these values are plausible, with shares less than being 3% for each country, these observation points are excluded from the analysis.

Table 6.4 Data missing from sample by country (UK/KSA) (source: SPSS)

Variable Name	Number of Missing	
	UK	KSA
Board Size	0	0
Non-executives in Board	0	2
Executives in Board	6	60
Board Meetings	0	0
Audit Committee Size	0	0
Audit Meetings	0	0
Profit Margin	8	5

ROE	0	1
Cash Ratio	0	0
Quick Ratio	18	0
Debt/Assets	0	0
Debt/Equity	0	0
Z-score	0	0
Tobin's Q	0	0
Total Missing	32	68
Total Observations	2184	2604
Share of Missing	1.5%	2.6%

6.7.2 Outliers

According to Tabachnick and Fidell (2007), an outlier is an anomalous (i.e., unexpectedly high or low) result, and it can be either a univariate outlier (anomalous for a single variable) or a multivariable outlier (anomalous across at least two variables). Non-normality is the typical outcome when outliers are included in the data set (Kline, 2005; Hair et al., 2006; Tabachnick and Fidell, 2007), but techniques exist that can be applied to detect and eliminate these. Such techniques include stem and box plots, histograms, leaf plots, and the calculation of z-scores. The presence of outliers can be determined by looking at the histograms, scatter plots or box-plot graphs, along with other methods.

In this study, the researcher has excluded 1.7% for the KSA and 4.2% for the UK. In some studies, around 3%, 5% or 10% are excluded for outliers in the analysis. For example, Murphy and Tresp (2006) remove around 10% of data due to outliers. Another study by Richter (2008) mentions that 5% or 10% of data are excluded in the course of analysis.

This statistical method is followed for both the UK and the KSA datasets. As shown in Table 6.5, below, this procedure leads to 43 outliers in the KSA data set (1.7% of total observations) and to 91 outliers in the UK data set (4.2% of observations). This intensity of outliers is plausible, with shares being less than 3% in the KSA and less than 5% in the UK, these observation points are consequently excluded from the analysis.

Table 6.5 Outliers data in UK & KSA (source SPSS)

Variable Name	Number of Outliers	
	UK	KSA
Board Size	1	0
Non-executives in Board	0	0
Executives in Board	1	0
Board Meetings	3	9
Audit Committee Size	0	0
Audit Meetings	1	4
Profit Margin	1	3
ROE	13	2
Cash Ratio	18	10
Quick Ratio	22	7
Debt/Assets	2	0
Debt/Equity	23	0
Z-score	0	0
Tobin's Q	6	8
Total Outliers	91	43
Total Observations	2184	2604
Share of Outliers	4.2%	1.7%

6.7.3 Descriptive Analysis

In this section, the study's descriptive analysis will be presented. Descriptive analysis helps in interpreting and evaluating the data's basic characteristics through mean, minimum, maximum, and standard deviation. Table 6.6 outlines the descriptive statistics for the target variables regarding the 156 UK firms and 186 KSA firms in this study, pertaining to a five-year timeframe.

Standard deviation (SD) refers to the level of variability in the variable's distribution, while data pertaining to the average scores for each variable is reflected in the minimum and maximum values. The descriptive statistics reveal, as they existed that during the studied

period, the selected corporate governance practices. These are calculated using characteristics of the board (such as frequency of meetings, size, as well as the number of board members that are executive and non-executive) and of the audit committee (such as size of the audit committee, its meeting frequency, profitability that is measured using ROE and profit margin, liquidity calculated using cash ratio and quick ratio, leverage calculated using debt/assets and debt/equity, financial health evaluated using Z score, and the firm value calculated using Tobin's Q). The board size's statistics for the UK and the KSA firms are a mean of 10 and 9 with a minimum value of 5 and 6 and a maximum value of 24 and 13, respectively. Hence, the mean values satisfy the Corporate Governance Codes of both the UK and the KSA, along with the requirements of company law, and they also satisfy Jensen's (1993) and Lipton and Lorsch's (1992) suggestions. Specifically, these researchers suggested that boards should contain between eight and 10 members (optimally, eight or nine members). This number is derived from the consideration that too many members can cause divisiveness and hinder decision-making, while too few members can be hampered by a lack of expertise and reduced breadth of experience. It is worthy of note that, in developing countries, boards typically have fewer members (potentially owing to nepotism), whereas the average board size for both Egypt and Malaysia is 8 (Elsayed, 2007; Haniffa and Hudaib, 2006), which contrasts with 12.25 for the US (Yermack, 1996). Nevertheless, the average for Australian firms is smaller, at 6.6 (Kiel and Nicholson, 2003).

As indicated in Table 6.6 60.37% of board members in the UK sample are non-executive, while this proportion is 40% for the KSA, with a range from 11% to 88%. Several researchers have found that, when a greater number of non-executives are included on a firm's board, the extent of information asymmetry between managerial personnel and investors is reduced (Black et al., 2006). Furthermore, the evidence indicates that boards typically perform more effectively in the presence of the guiding role that non-executive members afford (Brickley et al., 1994). The percentage of non-executive board members in the UK and the KSA is not as large when comparatively examined against other countries, including the US at 54% (Yermack, 1996) and Malaysia at 50% (Haniffa and Hudaib, 2006). In addition, the average in terms of board meetings for the UK is 80.44%, while this figure is 50.25% for the KSA. The number of formal board meetings held is between three and 25 in the UK and one to 13 in the KSA, as Table 6.6 shows. The intensity/frequency of board meetings is a signal that communicates the ability of the board to function effectively, and to optimise the system for shareholding control and monitoring. The average audit size, in both the UK and the KSA, is almost four. The minimum number of audit committee members is two and three respectively (mandated by law) and the maximum is seven in the UK and the KSA respectively. Audit committees meet five times in a year, on average, in both countries.

The results of the descriptive statistics test show that the executive director has a minimum value of 0.0% in both countries and a maximum value of 11% in the UK and 30% in the KSA. The profitability ratios, measured by profit margin and ROE are 17.7% in UK, 22.1% in KSA and the mean of ROE is 12.8%, 10.7% in the UK and the KSA respectively. The debt/equity ratio stood at 265%, 203% and debt/ assets averaged 55.6%, 50.1% in the UK and the KSA respectively. The quick ratio average is 17% for the UK and 18.5% for the KSA, which indicates a significant level of liquidity. In Europe, on average, the quick ratio stands for 80-90 in the UK and the KSA respectively. The average of Tobin's Q is 0.909, 1.1 while maximum value is 4.7, 8 and minimum value is 0.01, 0.16 in the UK and the KSA respectively.

Indicators	UK					KSA				
	N	Minimum	Maximum	Mean	Std. Deviation	N	Minimum	Maximum	Mean	Std. Deviation
BONon_EXC	156	2	15	6.37	2.995	186	0	8	4.01	1.751
BOSIZ	156	5	24	10.41	3.621	186	6	13	9.05	1.603
AUMEE	156	2	15	5.04	2.642	186	1	20	4.97	2.475
AUSIZ	156	2	7	3.99	1.000	186	3	7	3.78	.792
Profit Margin	156	-.2127	2.096	.177	.240	186	-4.702	1.900	.221	.492
ROE	156	-.440	.8456	.128	.135	186	-.8261	.500	.107	.123
Quick Ratio	156	.00	21.61	1.725	2.278	186	-2.027	36.856	1.87	3.847
Cash Ratio	156	.021	21.194	1.117	2.147	186	.033	35.443	1.206	3.730
Debt/Equity	156	-10.353	28.066	2.649	5.365	186	.0302	7.263	2.029	2.162
Debt/ Assets	156	.03	1.60	.5598	.29661	186	.029	1.077	.501	.250
Tobin's Q	156	.01	4.70	.9095	.76924	186	.16	8.00	1.091	1.183
BOMEE	156	3	25	8.44	2.989	186	1	13	5.25	2.326
Z.Score	156	.1	5.0	1.958	1.2097	186	.0186	5.598	1.909	1.386 2
BOEXE	156	0	11	3.04	1.850	186	0	3	.87	.739

Table 6.6 Descriptive Analysis in UK & KSA datasets (source: SPSS)

6.7.4 Correlation Analysis

The correlation matrix for the variables included in the analysis is in Tables 6.7 and 6.8 for the KSA and the UK, respectively. To determine the magnitude and direction of the variables' linear relationship, a correlation matrix was used which clarified the correlation problem. The significant association is identified at confidence level of 95% and 99%. Considering the tables, there is an important relationship between numerous corporate governance variables (including, board size, non-executives, executives, board meetings, and audit committee meetings and size) and quick ratio, debt/assets, cash ratio, Z-score, debt/equity, and the ROE for the UK and the KSA.

There is high significant positive correlation between firma value and financial health and ROE at 0.345 and 0.392, respectively (see Table 6.7). Further, there is high negative correlation between financial health and leverage indicators at -0.932 for debt/assets ratio and -0.763 for debts/equity. There is a significantly high correlation between liquidity (quick ratio and cash ratio) at (0.988) and leverage indicators (debts/equity and debt/assets) at 0.878. In table 6-8 shows correlation matrix for the UK, as seen that firma value and financial health have the highest significant positive correlation with profit margin and quick ratio (0.458 and 0.430 correspondingly). In the same context time leverage and financial health have the highest negative correlation with liquidity indicator: quick ratio (-0.540) and debts/assets (-0.428). There is a significantly high correlation between liquidity (quick ratio and cash ratio) at 0.921 and board size with audit meeting at 0.590.

Table 6.7 Correlation Matrix for KSA (source : SPSS)

Indicators	BONon_EXC	BOSIZ	AUMEE	AUSIZ	Profit Margin	ROE	Quick Ratio	Cash Ratio	Debt/Equity	Debt/ Assets	Tobin's Q	BOMEE	Z.Score	BOEXE
BONon_EXC	1													
BOSIZ	.395**	1												
AUMEE	.200**	.212**	1											
AUSIZ	.223**	.316**	0.135	1										
Profit Margin	-0.041	0.069	-0.003	-0.075	1									
ROE	0.066	-0.005	0.064	-0.055	.479**	1								
Quick Ratio	-0.074	-0.119	-.207**	-0.052	0.002	-0.038	1							
Cash Ratio	-0.044	-0.086	-.191**	-0.055	-0.012	-0.072	.988**	1						
Debt/Equity	.184*	.320**	.188*	.233**	0.084	-.148*	-.153*	-0.104	1					
Debt/ Assets	.209**	.323**	.190**	.274**	-0.013	-.158*	-.183*	-0.127	.878**	1				
Tobin's Q	-0.143	-.313**	-.169*	-.218**	0.065	.345**	.176*	0.123	-.480**	-.592**	1			
BOMEE	0.008	-0.015	.384**	0.094	-0.085	0.004	-0.018	-0.039	-.180*	-.215**	.153*	1		
Z.Score	-.194**	-.304**	-.144*	-.272**	.217**	.392**	.160*	0.091	-.763**	-.932**	.644**	.201**	1	
BOEXE	-.229**	0.033	-.185*	.164*	-0.007	-0.139	0.06	0.064	.209**	.198**	-.221**	-0.019	-.211**	1

** Correlation is significant at the 0.01 level (2-tailed), * Correlation is significant at the 0.05 level (2-tailed).

Table 6.8 Correlation Matrix for UK (source: SPSS)

Indicators	BONon_EXC	BOSIZ	AUMEE	AUSIZ	Profit Margin	ROE	Quick Ratio	Cash Ratio	Debt/Equity	Debt/ Assets	Tobin's Q	BOMEE	Z.Score	BOEXE
BONon_EXC	1													
BOSIZ	.827**	1												
AUMEE	.596**	.590**	1											
AUSIZ	.337**	.482**	.266**	1										
Profit Margin	.188*	0.045	-0.06	-0.028	1									
ROE	-0.103	-0.145	-0.119	-.226**	.210**	1								
Quick Ratio	-0.71	-.182*	-0.147	-.231**	.261**	.314**	1							
Cash Ratio	0.063	-0.007	-0.057	-0.156	.180*	.258**	.921**	1						
Debt/Equity	.550**	.590**	.469**	.378**	-0.094	-.176*	-.285**	-0.105	1					
Debt/ Assets	.183*	.317**	0.146	.368**	-.365**	-.275**	-.540**	-.374**	.413**	1				
Tobin's Q	-.284**	-.373**	-.318**	-.276**	.458**	.290**	.324**	0.135	-.376**	-.581**	1			
BOMEE	0.095	.199*	.370**	0.018	-.243**	-0.08	-.263**	-.231**	-0.057	.271**	-.289**	1		
Z.Score	-.170*	-.358**	-0.156	-.324**	.380**	-0.08	.430**	.301**	-.347**	-.428**	.500**	-0.146	1	
BOEXE	-0.027	.484**	.178*	.283**	-0.146	-0.023291	-0.121	-0.078	0.113	0.126	-0.157	.248**	-.338**	1

** Correlation is significant at the 0.01 level (2-tailed), * Correlation is significant at the 0.05 level (2-tailed).

6.8 SUMMARY

The core of this chapter has been an examination of the philosophical and methodological considerations that should be involved when formulating research designs, and this was followed by a description of the deductive, positivistic, and quantitative design chosen by this study to employ the EPTM. In addition, a review of structural equation modelling (SEM) methods has been presented, many of which are commonly used in various disciplines. In turn, the main points of distinction between CB-SEM and PLS-SEM were examined. Finally, data preparation and analysis were examined, and this was followed by a presentation of descriptive statistics.

Chapter 7

RESULTS OF TESTING THE MAIN MODEL

7.1 INTRODUCTION

This chapter provides an overview of the empirical outcomes of the EPTM, a description of which can be found in Chapter 3. This is accompanied by the relevant evaluation and tests described in the previous chapter. The first section describes the main strategy of testing the model. The results of the research are evaluated in two-step way in parallel to measurement model and structural model. The reliability and validity of indicator variables in generating construct variables are examined, using relevant methods and tests. Overall, results on the measurement model show that indicator variables satisfy the related tests. Then, the validity and performance of the structural model and relationships amongst constructs are evaluated. Results concerning this model show that of many proposed relationships, a limited number are found to be valid and statistically significant in the data.

7.2 TESTING THE MAIN MODEL

The main model aims to examine the relationship between perceptions, information, judgement and making a decision. Figure 7.1 presents the measurement and structural properties of the main model. Structural model (or the inner model) is shown by the blue circles and the arrows amongst them. As Chapter 3 explains in great detail, the structural model assumes that there are three different ways or paths of reaching a decision. In the first path (Expedient Path), one can go directly from perceptions (based on the characteristics of the board and audit committee) whilst the second path (Ruling Guide Path) assumes that perceptions affect the judgement and in return, judgement affects decision. Another separate path (Analytical Path) implies that information (based on profits, leverage and liquidity) affects judgement, and that judgement affects the decision. So, in the structural model, perceptions and information are exogenous latent variables, whilst information is the mediating or moderating endogenous latent variable and decision is the final endogenous latent variable.

The structural model and measurement model (the inner and outer models, respectively) are given in Figure 7.1, indicated as yellow rectangles with arrows. The unobservable latent variables of perceptions, information, judgement and decision are measured by some observable indicator variables, in reflective way. For judgement and decision, there are single indicator variables of financial health measured by the Z-score and firm value measured by Tobin's Q, respectively. For the latent variables of perceptions and information, there are further sub-latent variables. For perceptions, one latent variable is measured by board characteristics and another latent variable is measured by audit committee characteristics. As detailed in Chapter 3, the attributes related to the audit committee and the board of directors are used as perceptions for the model, having a direct or an indirect impact depending on their judgment impact. Regarding the indicator relationship, for the latent variable based on board characteristics, four observable variables are used. These include board size, the number of non-executives/executives on the board, and the frequency of board meetings. Regarding the latent variable, this is based on audit committee characteristics, and a pair of observable variables audit committee size and frequency of audit committee meetings is employed. With respect to the perception latent variables, the supposition is made of a reflective relationship with indicator variables. In this relationship, indicator variables reflect the main properties of unobservable latent variables, and they are a representative sample of a real latent variable.

There are several indicator variables for the latent variable of information, as well. This latent variable is examined in three sub-latent variables of information on profitability, liquidity and leverage. A pair of indicator variables (profit margin and ROE) is employed for profit; for liquidity, the cash ratio and quick ratio are the indicator variables; and for leverage, debt/assets and debt/equity are employed as indicator variables. It was noted in Chapter 3 that these indicator variables, along with their latent variables, are regarded as having an impact on the decision (owing to their mediating impact on judgment). In contrast to the reflective relationship in perceptions' latent variables (arrows going from latent variable to indicator variables), for information latent variables, a reflective relationship is assumed (arrows going from latent variable to the relevant indicator variables). Thereby, each indicator variable is necessary to establish correctly the relationship between latent variable and indicator.

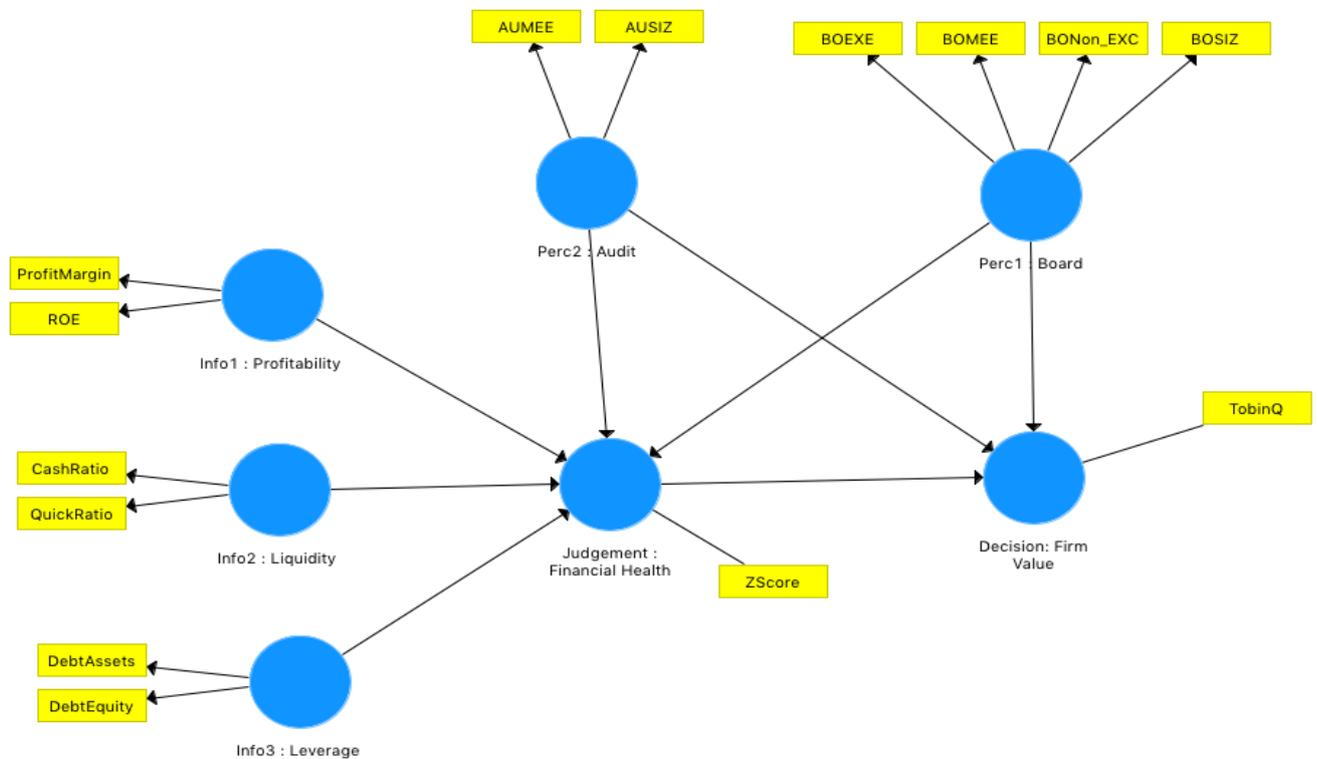


Figure 7.1 Measurement & Structural specifications of Main Model

7.2.1 Evaluating the Measurement Model

The model described above is estimated using SmartPLS software and PLS-SEM methodology. The performances of the model, how well it fits the data and whether the proposed hypotheses hold, are all evaluated in this section.

There are two main dimensions in the evaluation of PLS-SEM models, as has been discussed in Chapter 6 and these assess the validity of the measurement model (through separate analyses of reflective measurements for indicator variables) and the structural model. With respect to the measurement model, based on the reflective relationship, the following are employed to evaluate validity: internal consistency validity, convergent validity, and discriminant validity (Hair et al., 2017).

7.2.1.1 Validity Assessment of Reflective Measurement Models

7.2.1.1.1 Assessing Internal Consistency Reliability

In evaluating the measurement model, it is highly important to ensure the reliability of internal consistency. This is done by examining the correlations amongst the indicator variables of the same construct or latent variable. In the reflective relationship, as each indicator variable is a reflection of the true unobserved variable, it is plausible that indicator variables for the same latent variable display some positive correlation amongst themselves. The SmartPLS software offers the following measures of internal consistency reliability: Composite Reliability (CR) Cronbach's Alpha (CA) (Bryman and Bell, 2015; Cronbach, 1951; Hair et al., 2017; Pallant, 2010).

Table 7.1 for the UK and Table 7.2 for the KSA present that all latent variables' CR values are more than the 0.70 acceptable value. Further, all constructs' CA values are above 0.70. Thus, as stated by Sekran and Bougie (2012), the internal consistency reliability concerning all of the present study's constructs that the literature referred to is strongly supported.

Table 7.1 Reliability and Validity of Indicator Variables for the UK firms (source: PLS)

Construct (Latent Variable)	Item (Indicator Variables)	Outer Loadings	Cronbach's Alpha (CA)	Composite Reliability (CR)	Average Variance Extracted (AVE)
Perceptions 1: Board Characteristics	Board Size	0.942	0.749	0.756	0.56
	Non-executives in Board	0.710			
	Executives in Board	0.747			
	Board Meetings	0.785			
Perceptions 2: Audit Committee	Audit Committee Size	0.831	0.784	0.763	0.618
	Audit Committee Meetings	0.738			
Information 1 : Profitability	Profit Margin	0.812	0.764	0.753	0.604
	Return on Equity	0.741			
Information 2 : Liquidity	Cash Ratio	0.969	0.927	0.979	0.959
	Quick Ratio	0.989			
Information 3 : Leverage	Debt/Assets	0.908	0.754	0.890	0.802
	Debt/Equity	0.884			

Table 7.2 Reliability and Validity of Indicator Variables for the KSA firms (source: PLS)

Construct (Latent Variable)	Item (Indicator Variables)	Outer Loadings	Cronbach's Alpha (CA)	Composite Reliability (CR)	Average Variance Extracted (AVE)
Perceptions 1: Board Characteristics	Board Size	0.852	0.760	0.821	0.521
	Non-executives in Board	0.762			
	Executives in Board	0.787			
	Board Meetings	0.707			
Perceptions 2: Audit Committee	Audit Committee Size	0.724	0.712	0.743	0.592
	Audit Committee Meetings	0.812			
Information 1 : Profitability	Profit Margin	0.762	0.648	0.840	0.726
	Return on Equity	0.933			
Information 2 : Liquidity	Cash Ratio	0.861	0.853	0.919	0.851
	Quick Ratio	0.980			
Information 3 : Leverage	Debt/Assets	0.975	0.935	0.968	0.938
	Debt/Equity	0.962			

7.2.1.1.2 Assessing Convergent Validity

Convergent validity checks whether one indicator for a specific latent variable is positively related to other indicator variables. As all reflective indicator variables are considered to be representing the same unobservable latent variable, there will be positive correlation amongst them (Chin, 1998; Hair et al., 2017). This validity measure is tested by using the Average Variance Extracted (AVE). This statistic measures the average common movement or variance amongst the indicator variables, and a value higher than 0.5 is seen to reflect acceptable or good convergent validity. As shown in Tables 7.1 and 7.2, in the UK and the KSA firms respectively, all constructs have met the threshold value of 0.50.

Another indicator of reliability for measurement model is the outer loadings of each indicator variable. They show how well the variance of an indicator variable is explained by the constructed measures. For this measure, a value of higher than 0.7 is desirable (Hair et al., 2017). As shown in Tables 7.1 and 7.2, in the UK and the KSA respectively the outer loading for constructs of model of this study are acceptable.

7.2.1.1.3 Assessing Discriminant Validity

Another property of measurement model that is tested to evaluate its performance is related to the specific contribution of an indicator variable to its latent variable. In other words, if an indicator variable contributes more to its construct than all other constructs, then it can be said that this variable has a unique contribution to the measurement model (Hair et al., 2017). This characteristic is called discriminant validity, and several techniques were used to test the discriminant validity in this study (Cross-Loadings, Fornell-Larcker Criterion and HTMT):

i- Cross-Loadings

As was outlined in the previous chapter, the approach characterised by the greatest level of directness involves a comparison of the outer loadings of an indicator variable with reference to cross-loadings (namely, item-level discriminant validity) (Henseler et al., 2015). This takes place with respect to its own construct, while the cross-loadings of the indicator variable are examined in relation to different constructs (Chin, 1998; Hair et al., 2017). Table 7.3 and 7.4 for the UK and the KSA respectively, show these loading values for the reflective indicator variables in both countries.

It is seen that all indicator variables have higher outer loadings to their own constructs than cross-loadings to other constructs. So, the results from outer loadings indicate that indicators have discriminant validity.

Variable	Profitability	Liquidity	Leverage	Audit Committee	Board Characteristics	Financial Health	Firm Value
Profit Margin	0.811	-0.173	-0.328	-0.019	-0.020	0.390	0.126
Return on Equity	0.741	0.243	0.174	-0.189	-0.102	-0.077	0.276
Cash Ratio	0.162	0.969	0.050	-0.119	0.005	-0.008	-0.017
Quick Ratio	-0.216	0.988	0.069	-0.257	-0.250	-0.048	0.237
Debt/Assets	-0.297	-0.179	0.907	0.376	0.452	-0.597	-0.462
Debt/Equity	-0.380	0.265	0.889	-0.073	-0.013	-0.607	0.093
Au-Size	0.066	-0.181	0.226	0.613	0.424	-0.324	-0.169
Au-Meeting	0.061	-0.208	0.061	0.866	0.568	-0.132	-0.284
Bo-Size	0.128	-0.356	0.196	0.634	0.930	-0.331	-0.293
Bo-Non-Executive	0.255	-0.409	0.006	0.554	0.791	-0.170	-0.296
Bo-Executive	-0.150	0.053	0.315	0.234	0.470	-0.336	-0.033
Bo-Meeting	-0.265	0.062	0.289	0.124	0.529	-0.211	-0.114
Z.Score	0.451	-0.051	-0.777	-0.301	-0.390	1.000	0.206
Tobin's Q	-0.015	0.277	-0.234	-0.280	-0.291	0.206	1.000

Table 7.3.Outer Loadings & Cross-Loadings for the UK (source: PLS)

Variable	Profitability	Liquidity	Leverage	Audit Committee	Board Characteristics	Financial Health	Firm Value
Profit Margin	0.762	0.092	-0.014	-0.110	-0.168	0.168	-0.139
Return on Equity	0.933	0.270	-0.209	-0.001	-0.088	0.362	0.283
Cash Ratio	0.114	0.861	-0.363	-0.185	0.076	0.384	0.281
Quick Ratio	0.294	0.980	-0.424	-0.177	-0.145	0.475	0.163
Debt/Assets	-0.185	-0.450	0.975	0.381	0.392	-0.932	-0.556
Debt/Equity	-0.118	-0.442	0.962	0.354	0.378	-0.763	-0.555
Au-Size	-0.075	-0.066	0.275	0.866	0.402	-0.272	-0.072
Au-Meeting	0.022	-0.214	0.298	0.613	0.174	-0.247	-0.214
Bo-Size	-0.087	-0.053	0.311	0.329	0.852	-0.304	-0.113
Bo-Non- Executive	-0.043	-0.137	0.192	0.228	0.762	-0.182	-0.067
Bo-Executive	-0.120	-0.015	0.187	-0.010	0.787	-0.211	-0.099
Bo-Meeting	0.053	-0.055	0.102	0.429	0.707	-0.051	-0.066
Z.Score	0.374	0.482	-0.939	-0.335	-0.375	1.000	0.567
Tobin's Q	0.224	0.200	-0.534	-0.193	-0.156	0.567	1.000

Table 7.4 Outer loadings & Cross-Loadings for the KSA (source: PLS)

ii- Fornell-Larcker Criterion

Another way to test the discriminant validity is to compare the average communality of an indicator variable with its own group of indicator variables, and with other groups of indicator variables. If the indicator variable makes a specific and unique contribution to its construct, then it would have higher average communality with its own group of indicator variables (Hair et al., 2017; Vinzi et al., 2010). The Fornell-Larcker criterion is a valuable way in which to illuminate the nature of this association, which shows that the square root of AVE for all constructs ought to be greater when compared against its relationship to different constructs. Table 7.5 and Table 7.6 present these statistics for both the UK and the KSA firms, respectively. As presented in the tables, with AVE's square root in bold, it is evident that no construct correlated with other constructs that had value more than AVE values' square root. Hence, they fulfil the requirements for discriminant validity.

Table 7.5 Fornell-Larcker Criterion for the UK (source: PLS)

Variable	Profitability	Liquidity	Leverage	Audit Committee	Board Characteristics	Financial Health	Firm Value
Profitability	0.852						
Liquidity	0.270	0.922					
Leverage	-0.195	-0.435	0.969				
Audit Committee	-0.029	-0.189	0.373	0.769			
Board Characteristics	-0.122	-0.103	0.380	0.361	0.567		
Financial Health	0.374	0.482	0.939	0.335	-0.375	1.000	
Firm Value	0.224	0.200	-0.534	0.193	-0.156	0.567	1.000

Table 7.6 Fornell-Larcker Criterion for the KSA (source: PLS)

Variable	Profitability	Liquidity	Leverage	Audit Committee	Board Characteristics	Financial Health	Firm Value
Profitability	0.772						
Liquidity	-0.312	0.979					
Leverage	-0.438	0.058	0.895				
Audit Committee	0.081	-0.245	0.192	0.792			
Board Characteristics	0.034	-0.287	0.279	0.620	0.705		
Financial Health	0.451	-0.051	-0.777	0.301	-0.390	1.000	
Firm Value	0.015	0.277	-0.234	0.280	-0.291	0.206	1.000

iii- Heterotrait-Monotrait Ratio (HTMT)

Another method to test discriminant validity is via the Heterotrait-Monotrait Ratio (HTMT), which examines the mean of correlations for indicator variables (Henseler et al., 2015). The value of HTMT higher than 1, then there is a lack of discriminant validity. If it is smaller than 1, present the valid correlation between the two constructs have to vary. However, a value of less than 0.85 is considered to imply discriminant validity (Kline, 2011), and other authors suggest a threshold of 0.90 (Henseler et al., 2015). In Table 7.7 and Table 7.8 for the UK and the KSA respectively, which suggests that all constructs' HTMT ratio values indicate have been achieved.

Table 7.7 Heterotrait-Monotrait Ratio Correlations (HTMT) for the UK (source: PLS)

Variable	Audit Committee	Board Characteristics	Financial Health	Firm Value	Leverage	Liquidity	Profitability
Audit Committee							
Board Characteristics	1.2341						
Financial Health	0.5363	0.4025					
Firm Value	0.5753	0.4926	0.5806				
Leverage	0.6630	0.5933	0.5670	0.4941			
Liquidity	0.2986	0.2369	0.3790	0.2393	0.3494		
Profitability	0.4603	0.4758	0.7683	0.8166	0.4577	0.5767	

Variable	Audit Committee	Board Characteristics	Financial Health	Firm Value	Leverage	Liquidity	Profitability
Audit Committee							
Board Characteristics	1.2341						
Financial Health	0.5363	0.4025					
Firm Value	0.5753	0.4926	0.5806				
Leverage	0.6630	0.5933	0.5670	0.4941			
Liquidity	0.2986	0.2369	0.3790	0.2393	0.3494		
Profitability	0.4603	0.4758	0.7683	0.8166	0.4577	0.5767	

Table 7.8 Heterotrait-Monotrait Ratio Correlations (HTMT) for the KSA (source: PLS)

7.2.1.2 Reliability & Validity of Single Item Constructs

In the measurement model, two latent variables of financial health and firm value have single measurement variables for themselves, i.e. Z-score for the financial health and Tobin's Q for the firm value. As there is only a single construct in these cases, standard reliability and validity tests cannot be applied to time. Two commonly used tests of Cronbach's alpha and composite reliability cannot be used for single constructs because these tests look at the positive relationship among the set of multiple item constructs (Sarstedt & Wilczynski, 2009).

Some alternative tests of reliability and validity are suggested in other studies like Wanous and Reichers (1996). These papers indicate that reliability measures whether very similar results would be produced if the same exercise is repeated many times. For the test of reliability in single item constructs, Wanous and Reichers (1996) suggest using the classic correction for attenuation formula:

$$r_{xy} = \frac{r_{xy}}{\sqrt{r_{xx} * r_{yy}}}$$

Where r_{xy} denotes to the correlation between constructs x (i.e. single item construct) and y (multi item construct) that can be taken from the result of path, and r_{xx} and r_{yy} are reliabilities of x and y constructs respectively. Here, r_{xy} is assumed to be 1.00 (Wanous & Reichers, 1996; Bergkvist, 2015). Therefore the formula becomes:

$$r_{xx} = \frac{r_{xy}^2}{r_{yy}}$$

This study, *Audit Committee* represents the multi-item construct (y) which is utilised to estimate the reliability of the single item constructs i.e. Judgement *Financial Health* (FH) and Decision *Firm Value* (FV). Accordingly, the reliability of Judgement FH and Decision FV constructs are calculated by the following two equations for the UK and the KSA respectively:

- For UK : $r_{FH} = \frac{(0.335)^2}{0.618} = \mathbf{1}$ & $r_{FV} = \frac{(0.193)^2}{0.618} = \mathbf{0.62}$
- For KSA : $r_{FH} = \frac{(0.301)^2}{0.592} = \mathbf{1}$ & $r_{FV} = \frac{(0.280)^2}{0.592} = \mathbf{0.95}$

The outcomes of these formal tests indicate that the reliability values for the two single item constructs for each country are within the acceptable area (Cronbach, 1951; Pallant, 2010).

7.3 Evaluating the Structural Model

The analysis above has looked at the performance of the measurement (i.e., outer) model and indicates that this model, and the related indicator variables, mostly satisfy the validity and reliability criteria to a large extent, with few indicators failing some tests.

Once the measurement model has been verified as valid, it is then required to assess the association between constructs or latent variables. Therefore, goodness of fit measures (including the R^2 value) should be examined, and the significance of path coefficients and direct effects should be investigated (Garson, 2016; Hair et al., 2017).

7.3.1 Coefficient of Determination R^2

The R^2 value indicates the degree to which an endogenous, latent variable's variance can be accounted for with reference to different latent variables (Vinzi et al., 2010). As a case in point, an R^2 value amounting to 0.20 is regarded as considerable in the context of research addressing consumer behaviour, whereas this value must exceed 0.75 to be satisfactory in research on consumer loyalty (Hair et al., 2017). Nevertheless, an appropriate general guideline identifies 0.50 as moderate, 0.25 as low, and 0.75 as considerable (Hair et al., 2017). In this study, for the UK, the highest value of R^2 is 0.67 for financial health and the lowest is 0.563 for firm value. For the KSA, the highest value of R^2 is 0.921 for financial health and the lowest is 0.326 for firm value. This shows that the structural model fits the KSA data and the UK data equally well. These values are also shown in Figures 7.2 and 7.3, in the circles of related variables. In view of this, the degree to which the structural model for the firm values and financial health has explanatory power is sufficient. In addition to this, the values are characterised by statistical significance, thereby meaning that the structural model has explanatory power.

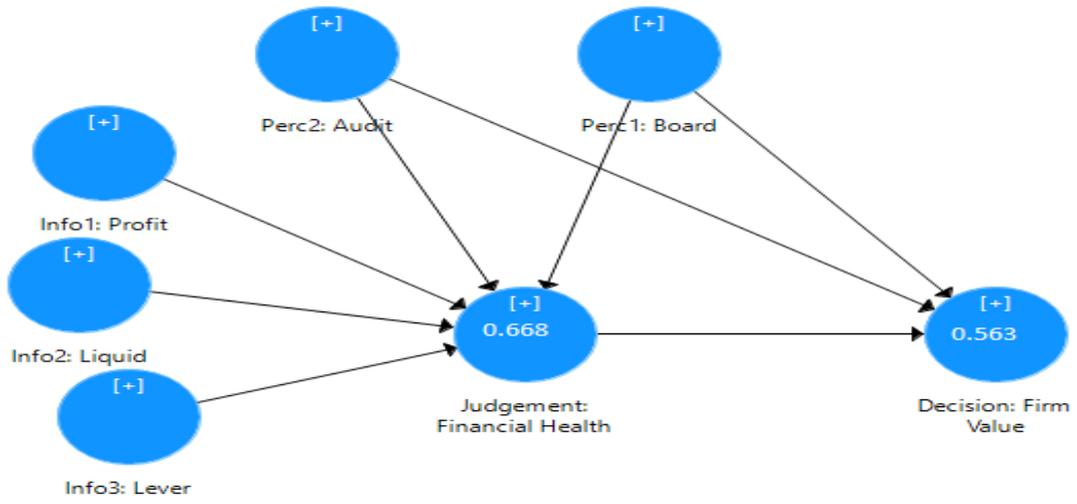


Figure 7.2 Structural model R^2 for the UK

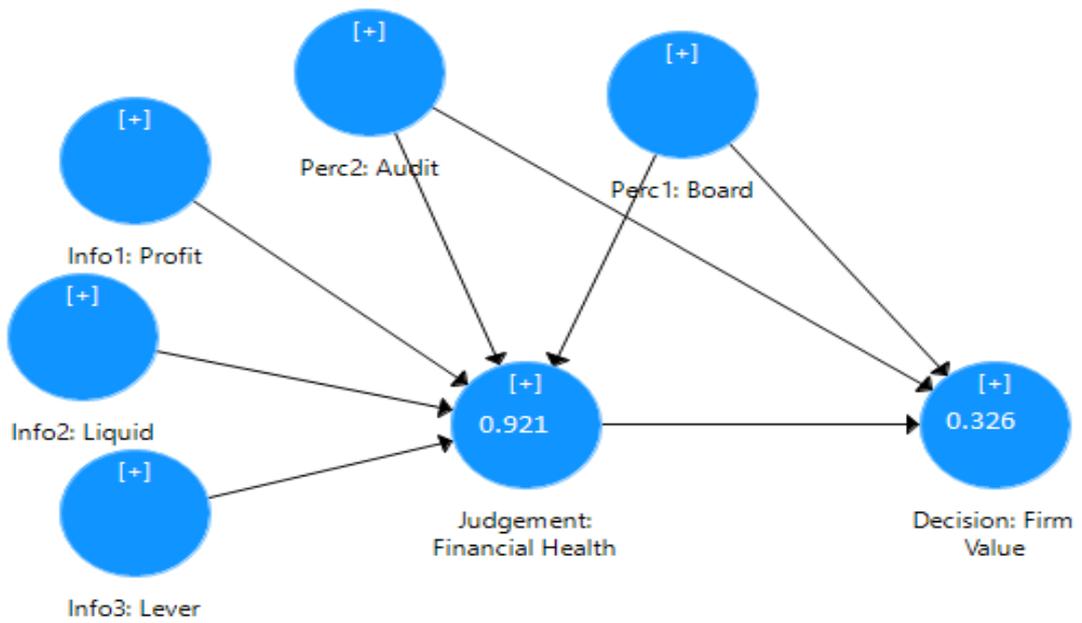


Figure 7.3 Structural model R^2 for the KSA

7.3.2 Effect Size (f^2)

The effect size (also called f^2) checks whether the omission of an explanatory variable in the structural model leads to important loss in R^2 (Garson, 2016; Hair et al., 2017). If so, this variable is considered important for the structural model. There are two constructs that have f^2 estimated for them, namely financial health and firm value. The effects sizes for these variables, in the case of both countries, are presented in Table 7-9. Here, the effects sizes of explanatory latent variables vary from medium (around 0.1 - 0.2) to high (around 0.3 - 0.4). Overall, the results of effect size assessments for the UK and KSA support the finding that relationships in the structural model are strong enough.

Variables	UK Firms			KSA Firms		
	Decision: Firm Value	Judgement: Financial Health	f^2	Decision: Firm Value	Judgement: Financial Health	f^2
Info1: Profit		0.18	Medium		0.41	Large
Info2: Liquid		0.22	Medium		0.24	Medium
Info3: Lever		0.34	Large		0.37	Large
Judgement: Financial Health	0.19		Medium	0.416		Large
Perc1: Board	0.16	0.48	Large	0.16	0.14	Medium
Perc2: Audit	0.26	0.17	Medium	0.23	0.26	Medium

Table 7.9 Effect Size (source: PLS)

7.3.3 Path Coefficients & Hypothesis Testing

The main focus of the PLS-SEM analysis is to derive some economic and statistically significant relationships amongst the construct variables, as depicted in the structural (i.e., inner) model as it discussed in Chapter 6. This relationship can be evaluated by examining the path coefficients (β). A path coefficient value that lies within the range from -1 to +1 can be conceptualised as positive or negative, where the strength of a positive or negative relationship is determined by the degree to which the value tends towards -1 or +1. Path coefficients directly estimate the effect of an explanatory construct variable on the endogenous construct variables, as proposed by the structural model.

Given that this study used the SmartPLS software for completing the PLS-SEM analysis, it was necessary to gauge the degree to which the coefficients were significant by applying non-parametric techniques relying on bootstrapping with respect to the t-statistic. For $t > 1.65$, $t > 1.96$, and $t > 2.57$, these indicated the following significance levels: $P < 0.10$, $P < 0.05$ and $P < 0.01$, respectively. Hence, as noted by Hair et al., (2017) and Vinzi et al., (2010), the values that exceeded this threshold indicated correlations. An overview of the path coefficients and path significances is given in Table 7.10 and Table 7.11.

Table 7.10 Direct Effect, firms in UK (source: PLS)

Hypothesis	Path	Path Coefficient (β)	STDEV	<i>t</i> Values	<i>p</i> Values	Accepted
H1	Perc1: Board -> Decision: Firm Value	0.159*	0.090	1.742	0.098	YES
H2	Perc2: Audit -> Decision: Firm Value	0.097*	0.060	1.876	0.092	YES
H3	Perc1: Board -> Judgement: Financial Health	0.168**	0.082	2.052	0.041	YES
H4	Perc2: Audit -> Judgement: Financial Health	0.207*	0.058	1.826	0.068	YES
H5	Info1: Profit -> Judgement: Financial Health	0.178***	0.061	2.907	0.004	YES
H6	Info2: Liquid -> Judgement: Financial Health	0.038**	0.034	1.955	0.062	YES
H7	Info3: Lever -> Judgement: Financial Health	-0.632***	0.095	6.648	0.000	NO

Note: Critical *t*-values for a two-tailed test are: 1.65* (Sig at $P < 0.10$), 1.96** (Sig at $P < 0.05$), and 2.57*** (Sig at $P < 0.01$)

Table 7.11 Direct Effect, firms in KSA (source: PLS)

Hypothesis	Path	Path Coefficient (β)	STDEV	t Values	p Values	Accepted
<i>H1</i>	Perc1: Board -> Decision: Firm Value	0.367***	0.054	6.734	0.000	YES
<i>H2</i>	Perc2: Audit -> Decision: Firm Value	0.176***	0.049	3.554	0.000	YES
<i>H3</i>	Perc1: Board -> Judgement: Financial Health	0.006*	0.036	1.702	0.865	YES
<i>H4</i>	Perc2: Audit -> Judgement: Financial Health	0.197***	0.067	2.937	0.003	YES
<i>H5</i>	Info1: Profit -> Judgement: Financial Health	0.259***	0.051	5.092	0.000	YES
<i>H6</i>	Info2: Liquid -> Judgement: Financial Health	0.386**	0.047	2.215	0.000	YES
<i>H7</i>	Info3: Lever -> Judgement: Financial Health	-0.835***	0.034	24.710	0.000	NO

Note: Critical t-values for a two-tailed test are: 1.65* (Sig at $P < 0.10$), 1.96** (Sig at $P < 0.05$), and 2.57*** (Sig at $P < 0.01$)

Hypotheses *H1* and *H2* have examined the association between the perceptions, which are board characteristics, audit committee and the decision, which is firm value. Hypotheses *H3* and *H4* examined the association between board characteristics and audit committee which are perception and judgment, which is financial health and hypotheses *H5*, *H6* and *H7* examined the association between information, which is profitability, liquidity and leverage, and judgment which is financial health .

In this context:

- **Hypothesis *H1*** expects that ‘Board characteristics perception have a positive impact on the firm value’. This hypothesis was supported in the UK context, where ($\beta = 0.159$, t-value = 1.742 that is significant at $P < 0.10$). It was also supported in KSA, where ($\beta = 0.367$, t-value = 6.734 that is significant at $P < 0.01$).
- **Hypothesis *H2*** expects that ‘The audit committee has a positive impact on the firm value’. This hypothesis was supported in the UK ($\beta = 0.097$, t-value = 1.867 that is significant at $P < 0.10$). It was also supported in the KSA ($\beta = 0.176$, t-value = 3.554 that is significant at $P < 0.01$).

- **Hypothesis H3** expects that ‘Board characteristics have a positive impact on the financial health of firms’. This hypothesis was supported in the UK ($\beta = 0.168$, t-value = 2.052 that is significant at $P < 0.05$). It was also supported in the KSA ($\beta = 0.006$, t-value = 1.702 that is significant at $P < 0.10$).
- **Hypothesis H4** expects that ‘The audit committee perception has a positive impact on the firm’s financial health’. This hypothesis was supported in the UK ($\beta = 0.207$, t-value = 1.826 that is significant at $P < 0.10$) and supported in the KSA ($\beta = 0.197$, t-value = 2.937 that is significant at $P < 0.01$).
- **Hypothesis H5** expects that ‘Profitability which is has a positive impact on the financial health of a firm’. This hypothesis was supported in the UK ($\beta = 0.178$, t-value = 2.907 that is significant at $P < 0.01$). It was also supported in the KSA ($\beta = 0.259$, t-value = 5.092 that is significant at $P < 0.01$).
- **Hypothesis H6** expects that ‘Liquidity has a positive impact on the financial health of a firm’. This hypothesis was supported in the UK ($\beta = 0.038$, t-value = 1.955 that is significant at $P < 0.05$). It was also supported in the KSA ($\beta = 0.386$, t-value = 2.215 that is significant at $P < 0.01$).
- **Hypothesis H7** expects that ‘Leverage has a positive impact on the financial health of firms’. This hypothesis must be rejected in both the UK and KSA contexts.

7.4 Testing the Mediation

As outlined in Chapter 6, the mediator impact occurs in the event that a construct (X2) plays a mediating role for a pair of other constructs (X1 and X3), which could be either consistent or inconsistent with the nature of the correlation (Eberl, 2010; Hair et al., 2017). According to Hair et al. (2017), a construct which plays a mediating role can be described as the transitive component in the relationship between two other variables. For example, when X1 changes, this impacts the mediating construct X2, which subsequently affects a change in the endogenous construct for the PLS path model. Nevertheless, it is important to note that sturdy theoretical grounds are needed to convincingly analyse mediator impacts (Hair et al., 2017).

In this study, the judgement (financial health) as a mediator between perception, which is board characteristics and audit committee, and decision, which is firm value, are hypothesised in *H3a* and *H4a* respectively. In addition, financial health as a mediator between information, which is profitability, liquidity and leverage, and decision, which is firm value, are hypothesised in *H5a*, *H6a* and *H7a*.

Based on the findings given in Tables 7.12 and 7.13;

- **Hypothesis *H3a*** expects that ‘Board characteristics have a positive impact on firm value through the financial health of the firm’. This hypothesis was supported in the UK ($\beta = 0.114$, t-value = 1.871 that is significant at $P < 0.10$).and also, was supported in the KSA ($\beta = 0.246$, t-value = 4.610 that is significant at $P < 0.01$).
- **Hypothesis *H4a*** expects that ‘The audit committee has a positive impact on firm value through the financial health of the firm. This hypothesis was supported in the UK ($\beta = 0.166$, t-value = 3.067 that is significant at $P < 0.01$) and supported in the KSA ($\beta = 0.127$, t-value = 2.761 that is significant at $P < 0.01$).

- **Hypothesis H5a** expects that ‘Profitability has a positive impact on firm value through the financial health of the firm. This hypothesis was supported in the UK ($\beta = 0.179$, t -value = 3.443 that is significant at $P < 0.01$).and also supported in the KSA ($\beta = 0.187$, t -value = 5.852 that is significant at $P < 0.01$).
- **Hypothesis H6a** expects that ‘Liquidity has a positive correlation on firm value through the financial health of the firm’ but not significant. This hypothesis was rejected in both the UK and the KSA settings.
- **Hypothesis H7a** expects that ‘Leverage has a negative correlation impact on firm value through the financial health of the firm’. This hypothesis was rejected in the UK and the KSA contexts.

Table 7.12 Indirect Effect in UK firms (source: PLS)

Hypothesis	Path	Path Coefficient (β)	STDEV	t Values	p Values	Accepted
H3a	Board -> Financial Health -> Firm Value	0.114*	0.061	1.871	0.061	YES
H4a	Audit -> Financial Health -> Firm Value	0.166***	0.054	3.067	0.002	YES
H5a	Profitability -> Financial Health -> Firm Value	0.179***	0.052	3.443	0.000	YES
H6a	Liquidity -> Financial Health -> Firm Value	0.098	0.066	1.483	0.138	NO
H7a	Leverage -> Financial Health -> Firm Value	-0.211***	0.057	3.687	0.000	NO

Note: Critical t-values for a two-tailed test are: 1.65 (Sig at $P < 0.10$), 1.96** (Sig at $P < 0.05$), and 2.57*** (Sig at $P < 0.01$)*

Table 7.13 Indirect Effect in KSA firms (source: PLS)

Hypothesis	Path	Path Coefficient (β)	STDEV	t Values	p Values	Accepted
H3a	Board -> Financial Health -> Firm Value	0.246***	0.053	4.610	0.000	YES
H4a	Audit -> Financial Health -> Firm Value	0.127***	0.046	2.761	0.006	YES
H5a	Profitability -> Financial Health -> Firm Value	0.187***	0.034	5.852	5.505	YES
H6a	Liquidity -> Financial Health -> Firm Value	0.009	0.026	0.361	0.730	NO
H7a	Leverage -> Financial Health -> Firm Value	-0.548***	0.046	11.860	0.000	NO

Note: Critical t-values for a two-tailed test are: 1.65 (Sig at $P < 0.10$), 1.96** (Sig at $P < 0.05$), and 2.57*** (Sig at $P < 0.01$)*

7.5 SUMMARY

The purpose of this chapter has been to outline the strategic approach applied to generate results from the EPTM. The PLS-SEM method was applied by drawing on the SmartPLS software, thereby facilitating the evaluation of the model's empirical performance. This is executed in two parts. The first part considers the reliability and validity of indicator variables in generating the construct variables. As the model involves unobservable latent variables of perceptions, information, judgement and decision, these variables are approximated using several indicator variables. That is to say, board and audit committee characteristics are used to generate perceptions, whilst profitability, leverage and liquidity are used to generate the information variable. Then financial health (measured by Z-score) and firm value (measured by Tobin's Q) are used for judgement and decision, respectively. These indicators are used in both reflective way when generating the constructs. Empirical results indicate that reliability and validity criteria are met, overall.

After ensuring that measurement model is validated and reliable to a large extent, the next empirical part looks at the relationships amongst constructs and examines the overall fit of the structural model. In this part, it is found that a number of relationships fit into the structural model and the proposed hypothesis. The model produces moderate to high explanatory power for the relationship amongst the constructs, and this is so in both countries. No major variables are found to have direct effects on the firm value in the UK. In contrast, the firm value variable in the KSA dataset, and financial health variable in both countries, produce plausible relationships with other constructs and their goodness of fit measures are plausible also.

Overall, the results of the research produce important insights and valuable information on the firm dynamics and decision-making in the UK and the KSA that be more discussed in chapter 8.

Chapter 8

DISCUSSION AND CONCLUSION

8.1 INTRODUCTION

The immediate aim of this chapter is to discuss the outcomes of the EPTM, thereby illuminating the connection between corporate governance practices and firm value, all the while taking into consideration the decision-making of relevant stakeholders. The discussion revolves around a general description of the model used, the research questions and the hypotheses that were tested.

A brief discussion on the SEM-PLS tool used to test the hypotheses is presented in this chapter, and consideration of the results of the tests concerning the use of the three pathways, and the inference drawn from these on the relationship between the research variables. Since the research has sought to examine the degree to which certain variables (including board characteristics, audit committee, profitability, liquidity, and leverage) are correlated with financial health and firm value, the focal point of this chapter is the discussion of these relationships in view of the literature. Besides the discussion on the results of the hypotheses tested, theoretical implications and practical professional contribution of this study are also explored as a part of this chapter.

It is important to recognise that, as is the case with all research projects, this study has been limited by a variety of methodological and procedural issues, and these will be discussed in due course. Finally, based on the findings and the theoretical implications of the study, possible avenues for further study are examined.

8.2 DISCUSSION ON THE TEST RESULTS OF THE MAIN MODEL

In this section, a general outline of the empirical model used for the research, the research questions that the research sought to answer and the hypotheses developed for testing, are presented. A discussion on the SEM-PLS tool used to test the hypotheses is also presented as a part of this section. The present study's theoretical model consists of two parts: the measurement model (the outer model) and the structural model (the inner model). It is worthy of note that the structural model involves a variety of suppositions, each made with respect to the utilisation of the expedient pathway, the ruling guide pathway, and the analytical pathway. Perceptions and information were considered as exogenous latent variables, while judgement was considered as the mediating or moderating endogenous latent variable. Any decision to be made as result of the interaction of perception and information is assumed to be the final endogenous latent variable for the working of the model. In using the measurement model, observable indicator variables were used because of the unobservable nature of the latent variables of perception, information, judgment and decision. For example, for measuring judgement and decision, single indicator variable of financial health of firms as measured by the Z-Score was used and the measure of Tobin's Q was used to assess the firm value.

The research questions framed took the form of three groups covering board characteristics, audit committee and firm characteristics. Generally speaking, the purpose of the research questions has been to investigate the effect that several variables (including board characteristics, audit committees, and firm-specific characteristics [e.g., profitability, liquidity, and leverage]) have on financial health and firm value in the UK and the KSA. The achievement of this purpose was predicated upon a comprehensive examination of the existing studies since this facilitated the formation of 12 hypotheses that the empirical model could then confirm or disconfirm. The hypotheses were all relevant to the research questions since confirmation or disconfirmation would directly inform the ultimately response to the research questions.

For testing the hypotheses through estimation of the model, the Structural Equation Modelling (SEM) tool was used, which was supported by the method of Partial Least Squares (PLS). The SEM-PLS tool focuses mainly on the derivation of relationships that are statistically significant among the construct variables. Model evaluation took place with the SEM-PLS model through the utilisation of path coefficients, where the value of the coefficients decided the degree to which certain variables were related. The results of the tests conducted to examine the relationships among variables when the three different pathways are used, are presented in the following sections of this chapter. The outcomes serve to demonstrate whether a correlation exists between one variable and another (and, furthermore, the nature of the correlation), thereby illuminating the matter of whether a certain hypothesis is either confirmed or disconfirmed. The meaning of the positivity of the relationships and a comparison of the relationships in the context of both the UK and the KSA companies is also presented in these sections.

8.2.1 First Pathway; The Expedient Pathway (P → D)

One of the three pathways individuals may consider in their decision-making process is the expedient pathway, the elements of which were explained earlier, in Chapter 3. As has been previously stated, there is no use of information in this pathway for decision choices, as the individual following this path is most likely to use his/her perceptions as the basis for arriving at a decision. An individual following the expedient pathway may not consider the positions taken by other people involved in the decision, and therefore, this pathway can be considered as the most direct pathway to arrive at the decision choice. The present study has employed the structural equation modelling-partial least squares (PLS) technique to determine whether the target variables are related in a statistically significant way. The reader was already presented with the results (see Chapter 7), and they will remember that the t-values of path coefficients revealed a positive correlation between board characteristics, audit committee, and firm value for UK companies. The t-values (see Table 7.10) were greater than the threshold support levels, thereby evidencing a statistically significant and positive correlation between board characteristics, audit committee, and firm value. As for the same analysis applied to the sample of firms from the KSA, the results in Table 7.11 also demonstrate a statistically significant and positive correlation. With respect to the board characteristics variables, the t-value was significant with $P < 0.01$.

The research examined the connection between board characteristics, audit committee and firm value, whereas an individual draw on the expedient pathway. Previous researchers, using different theoretical approaches, have examined the impact of board characteristics such as board size, number of independent directors and CEO duality on the firm value. As a case in point, the study conducted by Dehaene et al., (2001) utilised agency theory in the process of determining that certain board characteristics (namely, size and the proportion of independent directors) were positively correlated with firm value (proxied by ROE). In Yermack (1996), stewardship theory was employed to reveal a negative correlation between one board characteristic (namely, board size) and firm value, thereby marking a contrast with the later result yielded by Dehaene et al., (2001). While comparing the literature on the impact of board characteristics on firm performance and the resultant firm value between the countries of United States and Singapore being developed and developing countries (just as in the case of the present study that focuses on United Kingdom and Saudi Arabia), it is learnt that Mak and Li (2001) could find a significant relationship between board size and firm performance in the context of Singapore. Mak and Kusnadi (2005) report a negative relationship between board size and firm performance. A similar finding was reported by Yermack (1996) for the US jurisdiction, which was later supported by Eisenberg et al. (1998). However, although the study by Coles et al. (2008) provided evidence for the negative association between board size and firm value in the case of simple US firms, the study reported a positive relationship between the two variables in the case of complex US firms. The argument of Coles et al. (2008) is that complex firms having many business segments that are subjected to high financial leverage may have greater requirements for outsider advice and hence they can be benefitted from the existence of larger boards. It is reported by Hillman and Dalziel (2003) that board characteristics by affecting the monitoring by the board contributes to increased firm value. Nevertheless, inconsistent findings were reported in Yermack (1996) since that analysis highlighted a statistically significant and negative relationship between board characteristics and firm value.

Other research projects have examined the relationship between audit committee characteristics and firm value, but it is notable that each study has adopted a slightly varying theoretical underpinning to account for the correlation. As a case in point, Reddy et al., (2010) drew on stakeholder theory to show that a positive correlation existed between audit committee and firm value. In Khanchel (2007), the researcher found a positive correlation between the frequency with which audit committees convened and firm value (proxied by the Q ratio), where the research itself drew on stakeholder theory as its theoretical basis. Taking the examples of United States and Singapore, the study by Mak and Kusnadi (2005) could not establish a positive relationship between audit committee size and firm value in the case of Singapore listed companies. This may be due to the fact that the composition of the audit committee is found to be less stringent in Singapore as compared to the United States context. In the United States, the New York Stock Exchange and NASDAQ have mandated that the audit committees must have at least three members and all of them must be independent having no relationship with the company (Klein, 2002). Although the modifications to Singapore Code of Corporate Governance made in 2012 require the audit committee members to be independent, they do not require **all** the audit committee members to be independent. In addition, in Singapore compliance with Code of Corporate Governance is not mandatory; the companies are required only to disclose any deviations in their annual report (Bradbury et al. 2006). Latest study by Kusnadi et al. (2015) examined the data relating to 423 companies listed in Singapore Exchange and found that audit committees having higher level of expertise could contribute to better corporate governance and increased firm value. However, the study could not establish any relationship between incremental independence of audit committee membership and improved firm performance and value.

In the context of the United States, Chan and Li, (2008) found that the presence of independent directors in the audit committee has helped the US firms to enhance firm value. Studies by Klein (2002) and Pomeroy and Thornton (2008) focused on the independence of the audit committee and the impact on the financial reporting quality. These studies found a positive association between audit committee independence and firm performance in the United States. Ghosh (2009) reports that the higher the proportion of audit committee members having supervisory expertise the higher was the opportunities for the US firms to enhance their value. On the basis of disclosure practices of US firms, Carcello and Neal (2003) found a significant negative association between percentage of independent directors in the audit committee and higher financial reporting quality leading to enhanced firm value. While earnings management has a significant impact on holding the firm value, Carcello et al. (2006) provided evidence to prove that audit committees having independent directors with financial and non-accounting expertise might prove to be beneficial in better earnings management in the case of US firms. However, this finding was contradicted in the study conducted by Krishnan and Visvanathan (2008), who could not find any significant impact of non-accounting financial expertise in improving the financial reporting quality. In the case of US firms it is also found that investment bankers and financial analysts present in audit committees can help the accounting experts in improving the financial reporting standards and firm value by offering their expertise (Dhaliwal et al. 2010).

The positive relationship found by this research corresponds to the findings from many previous research studies. One study which yielded consistent results was that conducted by O'Connell and Cramer (2010), and this was also the case for the earlier study conducted by Dehaene et al., (2001). Other studies with consistent results with respect to the correlation between audit committee and firm value include Al-Matari et al., (2012), Khanchel (2007), and Reddy et al., (2010). In addition, Bozec (2005) and Hsu and Petchsakulwong (2010) reported contrasting results, since they identified a negative correlation between audit committee functioning and firm value.

In the event that a positive correlation is observed between board characteristics and firm value, the fact that board characteristics are related to a critical corporate governance practices means that such attributes have a favourable impact on the effectiveness with which the firm can augment its value. For instance, when the board is of a proper size, with optimum number independent directors and separation of CEO role, such a board can contribute significantly to the business growth and profitability of the organisation, which in turn will increase the firm value. The competitiveness of the organisation and its ability to enhance the firm value is dependent heavily upon the ability of the board to guide the organisation in the proper direction. The ability of the board to provide guidance and direction depends much on its characteristics. In view of this, when a firm is established in an appropriate way, insofar as it satisfies all its structural and functional requirements, the firm is expected to enjoy several advantages with respect to the achievement and augmentation of its value. Comparably, regarding the audit committee variables, including size, frequency of meetings, independence, and expertise, a positive correlation between these variables and firm value means that each characteristic is a statistically significant predictor of firm value, and therefore, effective corporate governance. Regarding the comparative examination between firms in the UK and those in the KSA, which constituted the focal point of the present study, the strength of the positive correlation for UK firms between board characteristics and firm value was not high ($P < 0.10$), while this was strong for the KSA firms ($P < 0.01$). In view of this, the correlation between the variables in question for firms in the KSA reflected greater significance than was the case for firms in the UK. Note worthily, the case was comparable for the relationship between audit committee characteristics and firm value.

8.2.2 Second Pathway; The Ruling Guide Pathway (P → J → D)

In this pathway, the emphasis is shifted to the judgments of an individual relating to particular decision choice process. An individual resort to using his/her judgement and perception regarding rules and laws in force while following the ruling guide pathway. Therefore, the information directly available does not influence the decision maker. Under this pathway, the individual travels directly from the problem framing stage to judgment stage by ignoring the information content. The assumption under this pathway is that rules are framed to provide the guidance for the behaviour of the people and such rules may act as an incentive for the people to follow a certain pre-defined behaviour. Based on the ruling guide pathway, an additional purpose of this study was to investigate the correlation between board characteristics and firm financial health, as well as audit committee characteristics and firm financial health. Based on the connection between firm financial health and firm value, the expectation was that it would be then reasonable to draw conclusions about the impact of these variables on firm value. The outcomes of the empirical tests for the UK and the KSA listed firms were given in Chapter 7, and it was noted that a positive correlation existed between board characteristics and financial health and audit committee characteristics and financial health. The results for the UK companies as depicted in Table 7.10 also indicate the existence of a statistically significant and positive relationship between these variables as shown by the higher t-values than the threshold limits. With respect to the KSA-listed firms, the t-values attested to a positive correlation between board characteristic, audit committee characteristics, and financial health, thereby justifying the conclusion that both groups of variables are statistically significant and positive predictors of KSA firms' financial health (see Table 7.11, where the t-values surpass the threshold value).

Several studies in the extant and related literature have investigated the way in which board characteristics have an impact on financial health. Drawing on resource dependence theory, Raheja (2005) concluded that no correlation existed between the two variables; while by using, agency theory (Belkhir, 2009) identified a positive correlation (where financial health was proxied with the Q ratio). According to Lehn et al., (2003), who drew on agency theory as the theoretical framework, no correlation was observed between two key board characteristics (namely, board size and board composition) and firm financial health. In the research conducted by Anderson et al.,

(2004), who examined the correlation between audit committee characteristics and firm financial health, resource dependence theory was used to lead to the conclusion that independence is favourable in lowering firm costs, thereby benefiting financial health. Raghunandan and Rama (2007) adopted stewardship theory to find that when the audit committee consists of more number of professional members, such committee will be able to contribute to increased financial health of the companies. The scope of the study was extended to identifying the effect that board characteristics and audit committee characteristics have on firm value, based on the way in which they affect firm financial health.

Continuing with the example of comparison between the United States and Singapore, although the corporate governance system of Singapore is regarded as the best in the Association of South East Nations (ASEAN) region, there are some important differences in the institutional environment of Singapore and other developed countries like the United States (Chuanrommanee & Swierczek, 2007). While there is complete protection of the rights of the minority shareholders, the ownership concentration is high in Singapore (Mak & Li, 2001; Witt, 2012). The external corporate governance mechanism in the form of the market for corporate control remains weak in Singapore, where takeover of corporations do not take place (Mak, 2007; Mak and Li, 2001). In addition, the Singapore government takes the role of significant block holder in many business corporations (Ang and Ding, 2006). These marked differences in the institutional system have made the role of boards in enhancing the financial health of firms rather limited in Singapore. Therefore, research has found a negative association between board characteristics and financial health of firms represented by the financial performance.

Ngyuen et al. (2014) studied the impact of board characteristics on firm financial performance in Singapore and have reported a significantly negative association between the two variables. It is evident from the literature especially from an agency theory perspective that with a small size board, the firm performance tends to increase (Jensen, 1993). In the case of Singapore, the size of the board has shown a negative correlation with firm performance and financial health which proves the fact that an organisation is likely to function less efficiently when there are more number of directors in the board resulting in lack of cooperation and chaos in decision making. With large number of members in the boards, it will take more time for a CEO in

Singapore to convince the board members which ultimately will reflect in deterioration of the financial health of the firm (Muth and Donaldson, 1998).

Despite the existence of improved institutional systems in the United States, research has provided mixed evidence of the impact of board characteristics on the financial performance and financial health of the companies. While some studies have reported a positive association between the two variables (e.g., Beiner et al. 2006), some studies have found a negative relationship (e.g., Mak & Kusnadi, 2005; Yermack, 1996). Few other studies have reported an insignificant relationship between board characteristics and financial performance of companies in the United States (e.g., Schultz et al. 2010; Wintokie et al. 2012). After the passing of the Sarbanes Oxley Act, board independence has become one of the key elements in the corporate governance system of the United States. As previous research has indicated, board composition is a critical element that helps in overseeing the firm performance leading to good financial health of companies. Although the advocates of agency theory are of the opinion that with effective monitoring and control over the performance of the companies through appointment of independent directors, improved long term financial health of the companies can be ensured, Valenti et al. (2011) found a negative association between board independence and firm financial performance in respect of 90 small and medium sized firms out of 120 firms examined by them. On the other hand, Dey (2008) found a positive association between board independence and firm financial performance in respect of 371 firms operating in the United States. Despite the mixed findings of previous research in the United States, it is common knowledge that a board having independent members with sufficient experience and knowledge could contribute to the effectiveness of the board functioning. However, in the case of smaller companies the presence of more directors might vitiate the vision of the CEO and thus would prove to be non-beneficial to the company. Therefore, it appears that the effectiveness of board functioning and financial health of companies may be impacted positively or negatively by board characteristics depending on the size of the company.

The present research's findings regarding the relation between firm value and board characteristics using the firms' financial health is supported by a number of previous research findings. According to Lehn et al., (2003), the board characteristics are an important element in augmenting the financial performance of a firm since the board happens to be the key source of firm-specific information relevant for the financial health. The study by Belkhir (2009) found that the board characteristic of the size of the board had a positive relationship with the financial health of the firm and thus with the firm value. In Hirschey et al., (2009), the conclusions drawn were consistent with those reported in the present study, since the researcher identified that the number of independent directors on a firm's board is a statistically significant predictor of firm value (owing to the way this influences financial health). Cicero et al., (2013) found that the board is in a position to provide the strategic direction to the organisation, which in turn will determine the extent to which the company can achieve its financial objectives.

The correlation between various aspects of a firm's audit committee and its financial health has formed the main area of inquiry for numerous studies in the past. The findings from many of such research are in agreement with the findings from this research. As a case in point, Carcello et al., (2003), Raghunandan and Rama (2007) and Chan and Li (2008) reported that the degree to which members of the audit committee hold finance-related expertise is a statistically significant predictor of positive financial health (thus affecting firm value). One way in which to account for this relationship is by referencing the point made by Anderson et al., (2004), who suggested that because audit committees are primarily concerned with the supervision of internal control system efficiency and financial reporting efficacy, their expertise is positive in aiding these practices. Clearly, when these practices are performed effectively and efficiently, the likelihood that a firm will experience a positive impact to its financial health and, therefore, value is considerably increased.

Given the consistent observation of a positive and statistically significant relationship between board characteristics and financial health (and, therefore, firm value), and similarly, between audit committee characteristics and firm value, it is logical to state when changes (in particular, changes for the better) are made to the dependent variables, the independent variable has a high probability of displaying a positive change. For example, if there are more financial experts in the audit committee, they will be able to guide the organisation towards better financial measures so that the company can

achieve its financial objectives. The test results of the UK and the KSA companies, when compared, reveal that the relationship between the audit committee and firm value through financial health show similar evidence in the case of KSA companies as compared to that of the UK companies because of similar P values observed in the case of both the UK and the KSA companies. However, in the case of board characteristics, the evidence for a positive relationship appears to be strong in the case of KSA companies as compared to the UK companies.

8.2.3 Third Pathway: The Analytical Pathway (I → J → D)

The values, attitudes and beliefs of the individuals form the basis of decision-making process while the analytical pathway is being used. These values help the individual to consider the ethical issues connected with the problem on hand and take appropriate decisions. Availability of relevant and reliable information is one of the pre-requisites of this pathway as such information is important to guide the individual through his/her decision-making process. The basic idea on which this pathway works is that it must be the endeavour of the society to ensure maximum balance of positive value available to all those affected. In this pathway, the direct information is likely to affect the decision choice directly, through the judgment of the individual. For the purpose of this research, according to the analytical pathway, the information that leads to a decision may be embedded with three factors profitability, liquidity and leverage that might affect the firm value through influencing the financial health of the firms. Thus, this research must evaluate the relationship between firm value and profitability, leverage, and liquidity by considering the UK and the KSA companies' financial health. This research used the SEM-PLS model to investigate the relationship between profitability, liquidity and leverage impact on financial health and firm value, the test results are reported in Chapter 7. Based on the previously documented empirical outcomes, especially the t-values given in Tables 7.10 and 7.11, profitability was correlated in a statistically significant way with financial health for the samples of both the UK and the KSA listed firms. This was also the case for liquidity and financial health. In contrast, leverage was identified as being correlated with financial health in a negative way for both nations' samples. Overall, however, based on the profitability measure, the empirical outcomes clearly indicate that this variable positively affects firm value (via financial health) on listed companies in the KSA and the UK (see Tables 7.12 and 7.13). Liquidity was found not to be correlated with firm value (via financial health) for the KSA and the

UK firms, while leverage was found to be negatively correlated with firm value (again, via financial health) in the KSA and the UK.

The relationship between profitability and firm value has been the focus of few research studies in the past. Haugen and Baker (1996) reported a positive association between the two variables. This finding was supported later by Yang et al., (2010) who used the Agency Theory to report the significant influence of profitability on firm value. Using Pecking Order Theory, Chen and Chen (2011) found the firm value to increase more with greater profitability of the firms. Mahdaleta et al., (2016) adopted Theory of Capital Structure and found profitability to have significant impact on enhancing the firm value. In the case of liquidity, Singh and Pandey (2008) using Stewardship Theory found effective working capital management and the resultant liquidity can have a positive impact on the financial health and firm value. Nazir and Afza (2009) have based their study on Stakeholder Theory and found that maintaining short-term liquidity may have a positive influence on the financial health and firm value of companies. As far as the relationship between leverage and financial health is concerned, Ruland and Zhou (2005) made use of Agency Theory to find that financial leverage enables firms to enhance the firm value. Pouraghajan and Malekian (2012), using the Theory of Capital Structure, found a higher relationship between debt ratio and the financial health of firms.

The positive relationship between profitability and financial health of companies as found by this research is supported by the findings of many previous research studies. For example, Haugen and Baker (1996) found a positive association between the two variables. Later, Mahdaleta et al., (2016) supported this finding by reporting a substantial influence of profitability on the firm value through improved financial health. Yang et al., (2010) noted that firms having greater profitability will have the opportunity to increase their earnings and hence will be able to add to their firm value. Bermig and Frick (2010) have also reported similar findings, which correspond with the findings of this research. Based on an analysis of the correlation between the liquidity and financial health of the firms, Lazaridis and Tryfonidis (2006) reported a positive relationship between the two variables, which is consistent with the present study's findings for the UK and the KSA listed firms. Nevertheless, after analysing various measures of liquidity, Raheman and Nasr (2007) observed a negative correlation between these variables, thereby contradicting this study's results. At the

same time, as a direct contrast to this study's results, the KSA-based research of Eljelly (2004) reported that liquidity and financial health were negatively correlated. Additionally, Nazir and Afza (2009) identified a negative relationship between liquidity and financial health, representing a contrast to the results reported here for the KSA and the UK firms.

The negative association between leverage and financial health found by this study is supported by the findings from many previous studies. For example, Quang and Xin (2014) have found a strong negative association between financial leverage and financial health of Vietnamese firms. Pouraghajan and Malekian, (2012) also reported on the negative association between leverage and financial health of firms in the context of Tehran-based companies. The study by Ebaid (2009) could not find strong evidence for a weak impact of financial leverage on the financial health of firms, although the study also failed to find a positive association.

The positive association between profitability and financial health implies that those organisations that are run profitably, will be able to increase their return on equity and thus can augment their financial health. The higher the profitability, the stronger the financial health of the firm. Strong financial health automatically increases the firm value, as the firm having higher profits can distribute more dividends to its shareholders and consistent growth in the profitability and financial health will be reflected as increased firm value. The positive association between liquidity and financial health can be interpreted to mean that with the optimum level of liquidity, a firm can manage its finances to its advantage, which in turn will enable the firm to increase its financial health. With sound financial health, the firm will be able to enhance its firm value in the long run. In view of this, it is reasonable to conclude that liquidity is a statistically significant and positive predictor of firm value (via financial health).

The positive correlation between leverage and firm value (via financial health) is indicative of the fact that an ideal capital structure has a considerable probability of improving firm value. This can be accounted for by referencing the way in which it is likely that the capital structure will have a cost-beneficial impact on the firm. Contrastingly, given the negative correlation between leverage and financial health, it can justifiably be concluded that the inability to regulate capital cost impairs a firm's financial performance and, thus, its value. Any wrong decision on the part of the

organisation to structure its capital at an optimum level, because of inappropriate leverage, might affect the ability of the organisation to augment its financial health and hence might result in reduction of the firm value. When the results in respect of the relationship between profitability and firm value through financial health for the UK and KSA companies are compared, the significance level appears to be the same. Therefore, the position of both UK and KSA companies in the matter of the relationship of profitability with firm value through financial health can be stated to be the same. The results also indicate that in respect of liquidity, the hypothesised assumption that liquidity has a positive relationship with firm value through financial health has been accepted in respect of KSA companies but rejected for the UK companies. Regarding the relationship between leverage and firm value (via financial health), the t-values and significance levels outlined in Chapter 7 attest to a negative correlation in both the KSA and the UK contexts.

8.3 THIS STUDY'S CONTRIBUTIONS

This study used the EPTM and the three pathways to construct the conceptual framework in order to provide the theoretical background to the study. The conceptual model's key suggestion is that fundamental corporate governance practices (namely, board characteristics and audit committee characteristics) have a positive impact on firm value and financial health. The study also sought to consider the influence of profitability, liquidity and leverage being the different elements of financial health of firms on the firm value. Based on the conceptual model 12 hypotheses were developed which were tested using SEM-PLS techniques.

On the basis of empirical evidence, this study provides support to the hypotheses that board characteristics and audit committee can have a positive influence on the financial health, as well as on the firm value. In addition, the results of the study indicate that liquidity and leverage may not enhance firm value, while it is possible for profitability to increase firm value (via financial health). The study observed the position of the variables in respect of the UK and the KSA companies and found similar test results for both the jurisdictions. Comparing the test results of the UK and the KSA companies determined that there is stronger evidence in the KSA companies of a positive relationship between audit committee, board characteristics, and firm value. Similarly, in the case of the relationship between board characteristics and firm value through

financial health, the statistical significance of the relationship is found to be stronger in the case of the KSA companies as opposed to those of the UK companies. On the other hand, the empirical evidence covering the relationship between audit committee and firm value through financial health appears to be similar in respect of both the UK and the KSA. In the case of the relationship between profitability and firm value through financial health, the results of this study indicate similar statistical significance levels in respect of both the UK and the KSA companies. However, no evidence has been produced by the tests that indicates a positive relationship of liquidity and leverage with firm value through financial health.

8.3.1 Theoretical Implications

For framing the conceptual framework, this study used the Ethical Process Thinking Model (EPTM) and the associated pathways. The conceptual model was developed using the EPTM, which is being used for the first time in corporate governance research under this study. The degree to which the model is useful when attempting to illuminate the impact that various corporate governance practices have on firm value and financial health was the main focal point of this research. The testing of the conceptual model has led to the following contributions to the existing literature. Initially, the results of the empirical assessment have contributed to the literature on this issue, and to the best of the researcher's knowledge, no previous studies have used the ETPM pathways to examine the variables in question and their correlations. In addition to this, the fact that the ETPM is distinctive, means that future researchers can use the methodology given in this research to guide their independent investigations of the way firm value, financial health, and growth are affected by various corporate governance practices. Thus, this study provides a broader theoretical base for corporate governance research that might be undertaken in the future. Third, by comparing the corporate governance practices in the UK and the KSA, this research provides an opportunity to relate the influence of these practices on the firm value in the respective countries. This comparison turns a new leaf in the literature, as the previous studies have compared only the firm value without reference to the underlying factors influencing that firm value. Lastly, this study makes an additional contribution to the literature because it focuses on corporate governance practices from a country perspective, rather than the internal corporate governance practices of the companies that have been the focus of most of the previous

studies. Such comparison can substantially enhance the ability of those in both the UK and the KSA to understand the implications of their respective practices.

8.3.2 Practical Contributions

From a practical perspective, the findings of this research have shown the importance of structuring a board appropriately and constituting an effective audit committee for ensuring the enhancement in firm value, in a manner applicable to companies both in the UK and in the KSA. On the basis of the empirical findings, the research has revealed that certain corporate governance practices are fundamental predictors of the degree to which a firm displays effective financial health.

In addition, the requirements that relating to corporate governance in the KSA improved and met to the established practices being followed in the OECD countries. This study, by highlighting the significant influence of board characteristics and audit committee on firm value and financial health, stresses the need for implementation of comparable corporate governance practices in the KSA. This need is particularly acute in light of the KSA's government having expressed its intention to steer the country's economy away from its dependence on oil; in such circumstances it becomes imperative that the private sector companies operate in a way that is conducive to economic development, which can be achieved by guaranteeing adherence to corporate governance codes, thus heightening financial health and firm value.

Secondly, the use of the ETPM in this kind of research, i.e. a study relating to corporate governance implications, has provided a practical approach to an area of research, where the expedient, the ruling guide and the analytical perceptions matter a great deal. By providing empirical results concerning these practical aspects of corporate governance practices, this research has laid the foundation for the conduct of many future research studies in the realm of corporate governance, and this is an important contribution, particularly given the ongoing importance of nation building, especially in the KSA.

8.4 LIMITATIONS

Several limitations of the present study must be acknowledged since these may have a negative impact on the degree to which the above-mentioned empirical results can be generalised. One of the theoretical limitations affecting this study is the lack of previous research that has used the EPTM in the realm of corporate governance. This paucity of corporate governance research using the EPTM has applied significant theoretical limitations to this study, as the conceptual model could not be augmented well with theoretical inferences from relevant previous research on corporate governance. The second limitation is the time and efforts spent on collecting sufficient data for manual testing. The researcher had no way of collecting comprehensive data from database sources such as Osiris, Thomson Reuters and Composite because most variables of KSA companies do not exist; each corporate annual report had to be studied manually, and data extracted accordingly, which has caused considerable delay in the process of conducting the research

Originally, the EPTM comprises six pathways, of which this study has used only three. The findings would have been more robust, had all six pathways been used. However, constraints on time and effort have precluded the use of all six of the pathways, which may be considered as one of the limitations of this study.

The sampling strategy adopted in this research could represent a limiting factor. Quantitative data for analysis was gathered from the annual reports of LSE-listed firms, as well as those listed on the Saudi stock exchange (Tadawul). Even though the corporate governance norms have been prescribed in both of these jurisdictions, there might be variations in the adoption of such norms, as companies operating in different sectors adopting different levels of compliance with respect to corporate governance practice. In the opinion of this researcher, these sectoral differences may place a serious limitation on the findings of this study.

The comparative nature of the study, between companies based in the UK and the KSA, also suffers from a limitation. The fact that the corporate governance standards are well defined and are being better implemented in the UK makes the comparison of the UK companies with those of the KSA companies somewhat unrepresentative of a broader reality. The corporate governance practices in the KSA are yet to be developed to meet the standards of those in the UK, and hence the comparison may be affected to the

extent of the differences in the intensity of implementation of corporate governance norms in the two jurisdictions. Nevertheless, it is reasonable to suggest that the research has achieved its aim, since it has been possible to draw concrete conclusions about the impact of various corporate governance mechanisms on firm value and financial health for both the UK and the KSA listed firms.

One of the methodological limitations to which this study is exposed emanates from the SEM-PLS technique used for the empirical analysis. The findings of this study are based on a sample of 156 companies from the UK and 186 companies from the KSA. As mentioned elsewhere, this sample size is small for a research study of this type and is a trade-off between the need to have sufficient data for parametric testing and the constraints involved in the manual collection of that data. Although the SEM-PLS technique can handle a smaller sample of this size, there is the lack of reliability in using this technique in the testing of the relationship between multiple latent variables, as this method differs from that of covariance-based structural equation modelling. According to Hair et al., (2013), the SEM-PLS technique requires multidimensional constructs to be precise linear combination of its dimensions, and therefore ignores or removes the error terms to eliminate error indeterminacy. Consequently, the error-bias measurements are not removed from the testing process. Therefore, use of the SEM-PLS technique itself has presented a major methodological limitation.

Another limitation that might be stated refers to the conceptual model developed for the study. The model may not be considered comprehensive, at least in the generally accepted sense, for several reasons. First, the model relied on specific latent variables, which were assumed to function as antecedents in guiding the decision-making process and the constructs involved in making such decisions. These variables, although they may have significant impact on the other variables, can at best be considered only as part of the endogenous construct variances. There are many other factors that might have an influence on the final judgments and decisions, which are not considered by this model. For example, the intellectual levels of directors and members of the audit committee, and their understanding of the need for and importance of the corporate governance practices (especially in the KSA), the availability of independent directors, the government's push towards implementation of corporate governance norms, the prevailing legal system and other governance metrics might easily affect the latent variables significantly. The model does not contain any moderating mechanism to

consider the impact of these factors, and this might have affected the findings of this study. In view of this, inferential reasoning must take place, with a view to the fact that the findings may not be generalisable to other countries (including Gulf countries and other developed states). This is because the Saudi economy is currently dependent largely on oil revenue, and the development of private companies in different sectors can be said to be in the nascent stage. Therefore, the KSA cannot be considered to represent other developing nations either in the Gulf region or elsewhere in the world, owing to the unique nature of its economy. Similarly, few similarities can be found between Saudi Arabia and other developed nations. Therefore, the findings from the conceptual model that worked for this research in the context of the KSA companies may not provide the opportunity for application in different contexts, without such modifications as may be necessary.

8.5 AREAS FOR FUTURE RESEARCH

Based on the tests conducted using the conceptual model, and the findings from the empirical tests, this study offers suggestions regarding areas for future research. Based on the analysis of the literature given in this research, it is clear that further research is required to address the current paucity of knowledge about the relationship between certain areas of corporate governance practice, financial health and firm value. In the event that readers are considering the possibility of conducting research in this area, they may benefit from further application of the EPTM, whether for international comparative examinations, or for correlational analyses. One fruitful area of research would be the comparative examination of the impact of corporate governance practices on firm value among firms, in both developed and developing countries, as this study attests to the value and viability of the EPTM as a framework to apply.

The three pathways of the EPTM have been employed in the present study to evaluate the correlation between various aspects of corporate governance and firm value (financial health). In view of this, this study could be extended, if future researchers were to incorporate the six pathways of the EPTM into their analysis, thereby gaining a more comprehensive insight into the issues that this study has illuminated. In addition, although the present research has been concerned with the corporate governance issues of board of directors and audit committees, other practices could serve as the focal point of future projects, including internal audit function and external audits. Furthermore,

the way in which each corporate governance practices is related to the others would benefit from multivariate investigations, perhaps using the EPTM and the relevant pathways.

Apart from the corporate governance in for-profit companies, the effectiveness of such practices in not-for-profit companies can also be evaluated, and this offers good potential for further research in the field of corporate governance, where again the EPTM could be applied to gain fresh insights. Another potential area for further research is to compare, contrast and analyse the corporate governance practices from the agency and stewardship theory perspective or from the agency and stakeholder theory perspective, with the application of a conceptual model based on the EPTM as used in this study. This area of research, using the EPTM, opens new avenues for many future research studies.

Another domain for future research could be an examination of the way in which the responsibilities of the board of directors (of publicly traded companies) have changed over time. Timeframes for analysis may include firm lifecycles. Within such a study, careful attention may be paid to corporate governance practices, so that the effectiveness of the roles and responsibilities of the directors, on enhancing the firm value through better corporate governance practices, can be evaluated and reported. Here again, the use of EPTM and the pathways may prove to be a useful tool for getting fresh inferences.

Another interesting area for further research in the context of the KSA, or any other Gulf nation or other developing or developed countries, could be the study of the success of family-owned enterprises. Such research may be empirical in nature, assessing the advantages and disadvantages of family ownership structures and the impact of such ownership on firm value. Analysing the impact using EPTM, basing the research on resource dependency theory, could explain the success or otherwise of these companies. Such research studies may also extend to the evolution and role of corporate governance in these firms, to enhance the firm value further.

To date, there appears to be limited number of qualitative research studies that have been conducted to investigate corporate governance and the associated concepts. Based on the suggestions advanced by Turley and Zaman (2007), it would be beneficial to conduct qualitative investigations into the responsibilities of audit committees, thereby illuminating the impact of their operations upon corporate governance in a contrasting way. Additionally, Beasley et al., (2009) have recommended that qualitative findings regarding the effect that internal audit oversight has on audit committee efficiency would represent valuable contributions to the literature. This study recommends further qualitative research in these and allied areas, wherein the EPTM can be used to derive better inferences. Such qualitative research is of paramount importance for better understanding the entire phenomenon of corporate governance from an audit committee perspective, and in such future research, the EPTM can be of immense value. This is because use of the conceptual model as being used in this study will provide a deeper insight into the investigation of the actual ways in which corporate governance mechanisms operate. The use of qualitative research combined with the EPTM model can prove to be a diverse methodological option, different from the quantitative method and helpful in promoting the value of future corporate governance research.

8.6 SUMMARY

This chapter has concluded the research report, highlighting the findings of the research and discussing the significance of the positive or negative association among different variables.

Overall, the findings of this research appear to correspond with the findings of the previous research on the subject. The implications of the findings of this research from theoretical and practical perspectives formed part of this chapter. Being the first of its kind to use EPTM in corporate governance research, this study has paved the way for the conduct of numerous further research studies, which are fully explained in this chapter.

The study also suffered from several methodological limitations, and other limitations on account of data collection. The explanations of such limitations were a part of this concluding chapter. Despite these limitations, the research has produced satisfactory findings that are relevant both theoretically and practically to the realm of corporate governance research. Based on the results of the comparative examination presented in this research, which has focused on firms listed on the LSE and the Saudi stock exchange, it is expected that the results will contribute valuably to the corporate governance literature. In particular, it is hoped that policymakers, government officials, and stakeholders in the KSA's world of business will take into consideration the findings reported here. Doing so will not only provide a novel perspective into the consequential nature of corporate governance mechanisms, but also present strong justification for the argument that corporate governance norms may need to be reinforced in certain contexts. Ultimately, however, the findings of this study, since they show that the impact of many of the KSA's corporate governance practices on firm value are approximately the same as the impact of the UK's corporate governance practices, lend considerable momentum to contemporary corporate governance arrangements in the KSA.

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Appendix A

 هيئة السوق المالية
Capital Market Authority



KINGDOM OF SAUDI ARABIA

Capital Market Authority

Corporate Governance Regulations

English Translation of the Official Arabic Text

Issued by the Board of the Capital Market Authority

Pursuant to Resolution Number (8-16-2017)

Dated 16/5/1438H Corresponding to 13/2/2017G Based on the
Companies Law Issued by Royal Decree No M/3 dated
28/1/1437H

Arabic is the official language of the Capital Market Authority

Important Notice: the current version of these Regulations, as
may be amended, can be found at

The Authority website: www.cma.org.sa

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Appendix (1) Remuneration Schedule

Part 1: Preliminary Provisions

Article 1: Definitions

The following terms and expressions shall have the meaning they bear as follows unless the contrary intention appears:

Companies Law: the Companies Law issued by Royal Decree No. (M/3) dated 28/1/1437 AH.

Capital Market Law: the Capital Market Law issued by Royal Decree No. (M/30) dated 2/6/1424 AH.

Listing Rules: The Listing Rules issued by the Board.

Authority: the Capital Market Authority.

The Exchange: The Saudi Stock Exchange.

Company: the listed joint stock company.

Board: the company's Board of Directors.

Corporate Governance: rules to lead and guide the Company that includes mechanisms to regulate the various relationships between the Board, Executive Directors, shareholders and Stakeholders, by establishing rules and procedures to facilitate the decision making process and add transparency and credibility to it with the objective of protecting the rights of shareholders and Stakeholders and achieving fairness, competitiveness and transparency on the Exchange and the business environment.

Shareholders Assembly: an assembly consisting of the shareholders in the Company formed in accordance with the provisions of the Companies Law and the Company's bylaws.

Executive Director: a member of the Board who is a full time member of the executive management team of the Company and participates in its daily activities.

Non-Executive Director: a member of the Board who is not a full-time member of the management team of the Company and does not participate in its daily activities.

Independent Director: a non-executive member of the Board who enjoys complete independence in his/her position and decisions and none of the independence affecting issues stipulated in Article 20 of these Regulations apply to him/her.

Executive Management or Senior Executive: persons responsible for managing the daily operations of the Company, and proposing and executing strategic decisions, such as the Chief Executive Officer (CEO) and his/her delegates and the Chief Financial Officer (CFO).

Relatives:

- Fathers, mothers, grandfathers and grandmothers (and their ancestors).
- children and grandchildren and their descendants.
- siblings, maternal and paternal half-siblings and their children. - Husbands and wives.

Holding Company: a Joint Stock Company or Limited Liability Company aims to control other Joint Stock Companies or Limited Liability Companies called affiliates by owning more than half of those companies' share capitals or by controlling the composition of their management.

Person: any natural or legal person that is recognised as such under the laws of the Kingdom.

Related Parties:

- A. Substantial Shareholders of the company.
- B. Board members of the Company or any of its affiliates and their relatives.

- C. Senior Executives of the Company or any of its affiliates and their relatives.
- D. Board members and Senior Executives of Substantial Shareholders of the company.
- E. Entities, other than companies, owned by a Board member or any Senior Executive or their relatives.
- F. Companies in which a Board member or a Senior Executive or any of their relatives is a partner.
- G. Companies in which a Board member or a Senior Executive or any of their relatives is a member of its Board of directors or is one of its Senior Executives.
- H. Joint stock companies in which a member of the Board or a Senior Executive or any of their relatives owns (5%) or more, subject to the provisions of paragraph (D) of this definition.
- I. Companies in which a Board member or a Senior Executive or any of their relatives has influence on their decisions even if only by giving advice or guidance.
- J. Any person whose advice or guidance influence the decisions of the Company, the Board and the Senior Executives.
- K. Holding companies or affiliates.

Advice or guidance that is provided on a professional basis by a person licensed to provide such advice shall be excluded from the provisions of paragraphs (I) and (J) of this definition.

The Group: When referring to a person, means the person and his affiliates.

Affiliate: a person who controls another person or is controlled by that other person, or who is under common control with that person by a third person. In any of the preceding, control could be direct or indirect.

Stakeholder: any person who has an interest in the Company, including employees, creditors, customers, suppliers and the community.

Substantial Shareholders: any person who owns (5%) or more of the shares of the Company or voting rights therein.

Cumulative voting: a method of voting for electing Board members that gives each shareholder a voting capacity equivalent to the number of shares he/she owns , and by which the shareholder is entitled to either exercise all of his/her votes towards one nominee or to divide his/her votes towards several nominees without any duplication of such votes.

Controlling Interest: The ability to influence actions or decisions of another person directly, indirectly, individually or collectively with a relative or an affiliate through: (A) owning %30 or more of the voting rights in a company, (B) having the right to appoint %30 or more of the administrative team members.

Administrative Team: A group of individuals who make strategic decisions of the person. The Board is the Company's Administrative Team.

Remunerations: amounts, allowances, dividends and the like, periodic or annual bonuses linked to performance, long or short term incentive plans and any other in-kind benefits except the actual reasonable expenses and fees incurred by the company to enable the Board member to perform his duties.

Day: Calendar day whether a business day or not.

Article 2: Preamble

- a) These Regulations state the rules and standards that regulate the management of the companies to ensure its compliance with the best governance practices that ensure the protection of shareholder's rights as well as the rights of Stakeholders.
- b) These Regulations are mandatory to companies except the provisions that contain a reference of being guiding.
- c) Without prejudice to the provisions of these Regulations, laws and instructions of other supervisory authorities apply to companies that subject to them.

Article 3: Objectives of the Regulations

These Regulations aim at establishing an effective legal framework to govern the Company, and particularly aim at the following:

- 1) enhancing the role of the Company's shareholders and facilitating the exercise of their rights;
- 2) Stating the competencies and responsibilities of the Board and the Executive Management;
- 3) enhancing the role of the Board and the committees and developing their capabilities to enhance the Company's decision making mechanisms;
- 4) achieving transparency, impartiality and equity in the Exchange, its transactions, and the business environment and enhance disclosure therein;
- 5) providing effective and balanced tools to deal with conflicts of interest;
- 6) enhancing accountability and control mechanisms for the Company's employees;
- 7) establishing the general framework for dealing with Stakeholders and protecting their rights;
- 8) supporting the effectiveness of the system for overseeing Companies and the tools thereof; and
- 9) raising the awareness of Companies in respect of the concept of professional conduct and encouraging them to adopt and develop such concept in accordance with their nature.

Part 2: Rights of Shareholders

Chapter 1: General Rights

Article 4: Fair Treatment of Shareholders

- a) The Board is obliged to seek shareholders' rights protection to ensure fairness and equality among them.

b) The Board and the Executive Management of the Company is obliged not to discriminate among shareholders who own the same class of shares nor prevent them from accessing any of their rights.

c) The Company shall specify in its internal policies the procedures that are necessary to guarantee that all shareholders exercise their rights.

Article 5: Rights related to shares

All rights related to shares shall be guaranteed to the shareholder, and particularly the following:

- 1) to obtain his/her portion of the net profits which are to be distributed in cash or through the issuance of shares;
- 2) to obtain his/her share of the Company's assets upon liquidation;
- 3) to attend the General or Special Shareholders Assemblies, take part in their deliberations and vote on their decisions;
- 4) to dispose of his/her shares in accordance with the provisions of the Companies Law, The Capital Market Law and their implementing regulations ;
- 5) to enquire and request viewing the books and documents of the Company, including the data and information related to the activities of the Company and its operational and investment strategy without prejudice to the interests of the Company or breach of the Companies Law and the Capital Market Law and their implementing regulations;
- 6) to monitor the performance of the Company and the activities of the Board;
- 7) to hold Board members accountable, to file liability lawsuits against them and appeal for nullification of the resolutions of the General and Special Shareholders Assemblies in accordance with the conditions and restrictions provided in the Companies Law and the bylaws of the Company;
- 8) preemptive rights to subscribe for new shares issued in exchange for cash unless otherwise specified in the Company's bylaws or when the Extraordinary General Assembly suspends the pre-emptive rights are per Article (140) of the Company's Law.

- 9) to record his/her name in the Company's shareholders register;
- 10) to request to view a copy of the Company's articles of association and bylaws unless the Company publishes them on its website; and 11) to nominate and elect the Board members.

Article 6: Shareholder access to information

- a) The Board shall make available to the shareholder complete, clear, accurate and nonmisleading information to enable him/her to properly exercise his/her rights. Such information shall be provided at the proper times and shall be updated regularly.
- b) The method used to provide information to the shareholders shall be clear and detailed and shall include a list of the Company's information that the shareholders may obtain. This information shall be made available to all shareholders of the same class.
- c) The Company shall use the most effective methods in communicating with shareholders and shall not discriminate among shareholders in respect of providing information.

Article 7: Communicating with Shareholders

- a) The Board shall ensure communication between the Company and the shareholders based on the common understanding of the strategic objectives and interests of the Company.
- b) The chairman of the Board and the Chief Executive Officer shall inform the remaining Board members of the opinions of the shareholders and discuss these opinions with them.
- c) No shareholder may intervene in the operations of the Board or the work of the Executive Management of the Company unless he/she is a member of its Board or its management team; or unless his/her intervention is through the Ordinary General Assembly according to its powers or within the limits and situations permitted by the Board.

Article 8: Electing the Board Members

- a) Upon calling for the General Assembly, the Company shall announce on the Exchange's website information about the nominees for the membership of the Board which shall include the nominees' experience, qualifications, skills and their previous and current jobs and memberships. The Company shall make a copy of the mentioned information available in the Company's head office and its website.
- b) Cumulative voting shall be used in electing the Board, in which it is not allowed to use the voting right of a single share more than once.
- c) Voting in the General Assembly shall be confined to the Board nominees whose information has been announced as per paragraph (a) of this Article.

Article 9: Distribution of Dividends

- a) The Company's bylaws shall prescribe the percentage of the net profits to be distributed to the shareholders after setting aside the statutory reserve and the other reserves.
- b) The Board shall establish a clear policy for the distribution of dividends to achieve the interests of the shareholders and the Company as per the Company's bylaw.
- c) The shareholder is entitled to receive his/her share of dividends as per the decision of the General Assembly in respect of the distribution of dividends to shareholders or the Board resolution on distributing interim dividends. The resolution shall specify the record date and the distribution date provided that the resolution shall be executed as per the Regulatory Rules and Procedures issued pursuant to the Companies Law related to Listed Joint Stock Companies.

Chapter 2: Rights Related to the Meeting of the General Assembly

Article 10: Preamble

General Shareholders Assemblies of the Company are competent in all of its affairs. A dulyconstituted General Assembly represents all shareholders in exercising their powers in respect of the Company. The General Assembly shall exercise its role in accordance with the provisions of the Companies Law and Its Implementing Regulations and the Company's bylaws.

Article 11: Competencies of the Extraordinary General Assembly

The Extraordinary General Assembly shall have the following Competencies:

- 1) amending the Company's bylaws, except for amendments which are deemed null and void pursuant to the provisions of the Companies Law;
- 2) increasing the Company's share capital in accordance with the situations provided by the Companies Law and Its Implementing Regulations;
- 3) decreasing the Company's share capital if it exceeds the Company's needs or in the event the Company incurs financial losses, in accordance with the situations provided by the Companies Law and Its Implementing Regulations;
- 4) resolving to form a consensual reserve for the Company as provided for in its bylaws to be set aside for a specific purpose, and the disposal thereof;
- 5) resolving to maintain or liquidate the Company before the end of the term specified in its bylaws;
- 6) approving the Company's shares buy-back;
- 7) issuing preferred shares or approving their buying, or converting ordinary shares into preferred shares or converting preferred shares into ordinary shares as per the Company's bylaws and the Regulatory Rules and Procedures issued pursuant to the Companies Law related to Listed Joint Stock Companies;
- 8) issuing debt instruments or financing deeds convertible into shares, and stating the maximum number of shares that may be issued against these instruments or deeds;
- 9) allocate Shares that are issued upon the capital increase or part of them for the employees of the Company, and its affiliates or some of them, or any of them; and
- 10) suspending preemptive rights of shareholders in subscribing for the capital increase in exchange for cash or giving priority to non-shareholders in cases as deemed in the interest of the Company if so is provided for in the Company's bylaws.

The Extraordinary General Assembly may issue resolutions that fall within the powers of the Ordinary General Assembly, provided that such resolutions are issued in accordance with the issuance requirements of Ordinary General Assembly resolutions which require that the absolute majority of shares be represented at the meeting.

Article 12: Competencies of the Ordinary General Assembly

Except for the competencies reserved to the Extraordinary General Assembly, the Ordinary General Assembly shall have competencies in all affairs of the Company, and particularly the following:

- 1) appointing and dismissing Board members;
- 2) permitting a Board member to have direct or indirect interest in the business and contracts that are executed for the Company's account, in compliance with the provisions of the Companies Law and Its Implementing Regulations;
- 3) permitting a Board member to take part in any activities that may lead to competition with the Company, or competition in any of its activities, in compliance with the provisions of the Companies Law and its Implementing Regulations;
- 4) monitoring the compliance of the Board members with the provisions of the Companies Law and Its Implementing Regulations and other relevant laws and the Company's bylaws; inspecting any damage that may occur as a result of their violation of such provisions or mismanagement of the affairs of the Company; determine the liability resulting therefrom and undertaking the procedures it deems proper in this regard pursuant to the Companies Law and Its Implementing Regulations;
- 5) forming the audit committee pursuant to the provisions of the Companies Law and Its Implementing Regulations;
- 6) approving the Company's financial statement ;
- 7) approving the Board report;
- 8) deciding on the proposals of the Board with respect to the method of distributing the net profits;

9) appointing the external auditors of the Company, specifying their remunerations, reappointing them, replacing them and approving their reports;

10) looking into the violations and errors committed by the external auditors of the Company when performing their duties and any difficulties, reported by the

Company's external auditors, regarding their empowerment by the Company's Board or Management to review the books, records and other documents, statements and clarifications required to perform their duties, and respond to that as it deems appropriate in this regard;

11) resolving to withhold from setting aside statutory reserve when it reaches an amount equal to (30%) of the Company's paid share capital, and resolving to distribute the surplus of such percentage to the Company's shareholders in financial years where the Company does not generate net profits;

12) using the Company's consensual reserve, if such has not been set aside for a specific purpose, provided that using such reserve shall be based on a proposal submitted by the Board and used in ways that benefit the Company or the shareholders;

13) forming other reserves besides the statutory reserve and consensual reserve and disposal of the same;

14) setting aside amounts from the Company's net profits to set up social organisations for the benefit of the Company's employees or to assist any such existing establishments in accordance with Article (129) of the Companies Law; and

15) approving the sale of more than (50%) of the assets of the Company, whether in one or several transactions within a period of 12 months from the date of the first selling transaction. In case selling these assets includes what falls within the powers of the Extraordinary General Assembly, the approval of the said Assembly is required.

Article 13: Shareholders' Assembly

- a) The Ordinary General assembly shall convene in accordance with the situations and circumstances stated in the Companies Law and Its Implementing Regulations and the Company's bylaws.
- b) The Ordinary General Assembly shall convene at least once per year within the six months following the end of the Company's financial year.
- c) The General and Special Shareholders' Assemblies shall convene upon an invitation from the Board in accordance with the situations stated in the Companies Law and Its Implementing Regulations and the Company's bylaws. The Board shall invite the Ordinary General Assembly to convene upon the request of the external auditor, the audit committee or a number of shareholders holding shares equal to at least (5%) of the share capital of the Company. The external auditor may invite the assembly to convene if the Board does not invite the assembly within thirty days from the date of the external auditor's request.
- d) The date, place and agenda of the General Assembly shall be announced at least ten days prior to the date thereof; the invitation shall be published on the website of the Exchange, the Company's website and in a daily newspaper distributed in the province where the Company's head office is located. The Company may invite the General and Special Shareholders' Assemblies to convene using methods of contemporary technologies.
- e) The Company may amend the agenda of the General Assembly within a period between publishing the announcement referred to in paragraph (d) of this Article and the date of convening the General Assembly meeting, provided that the Company shall announce this as prescribed in paragraph (d) of this Article.
- f) Shareholders shall be granted the opportunity to effectively participate and vote in the General Assembly meetings. The meetings of the General Assemblies of shareholders may be convened and shareholders may participate in their deliberations and vote on their resolutions using methods of contemporary technologies pursuant to the Regulatory Rules and Procedures issued pursuant to the Companies Law related to Listed Joint Stock Companies.

g) The Board shall work on facilitating the participation of the largest number of shareholders in the meetings of the General Assembly, including choosing the appropriate place and time of such meeting.

h) The Company shall ensure recording the details of the shareholders who desire to attend at the Company's head office prior to the specified time for convening the assembly, unless the Company's bylaw state other means.

Article 14: The Agenda of the General Assembly

a) When preparing the General Assembly's agenda, the Board shall take into consideration the matters that the shareholders wish to list; shareholders holding no less than (5%) of the Company's shares are entitled to add one or more items to the agenda upon its preparation.

b) The Board shall separate each of the matters listed in the agenda of the General Assembly meeting as an independent item, and not combine significantly different matters under one item, and not combine the businesses and contracts in which Board members have a direct or indirect interest under one item, for the purpose of obtaining the shareholders' vote for the item as a whole.

c) The shareholders shall be allowed through the Company's website and the Exchange's website, when the invitation for the convention of the General Assembly is published, to obtain the information related to the items of the General Assembly's agenda, particularly the reports of the Board and the external auditor, the financial statements and the audit committee's Report in order to enable them to make an informed decision in this regard. The Company shall update this information in case the General Assembly's agenda was amended.

d) The Authority may add any items it deems appropriate to the agenda of the General Assembly.

Article 15: Management of the Shareholders' Assembly

a) The Shareholders' General Assembly meetings shall be chaired by the chairman, his deputy (if the chairman is absent) or whom is delegated by the Board of directors of its members (when the chairman and his deputy are absent).

- b) The chairman of the Shareholders' Assembly shall commit to grant the shareholders the opportunity to effectively participate and vote in the meetings of the General Assembly,, and avoid any procedure that may preventing their attendance to the assemblies or the exercise of the voting right. Shareholders shall be informed of the rules governing such meetings and the voting procedures.
- c) Shareholders are entitled to discuss matters listed in the agenda of the General Assembly and raise relevant questions to the Board members and to the external auditor. The Board or the external auditor shall answer the questions raised by shareholders to the extent that does not jeopardise the Company's interest.
- d) Shareholders shall be granted access to the minutes of the General Assembly meeting; and the Company shall provide the Authority with a copy of such minutes within (10) days of the date of any such meeting.
- e) A Company shall announce to the public and inform the Authority and the Exchange, as per the rules prescribed by the Authority, of the results of a General Assembly meeting immediately following its conclusion.

Part 3: The Board of Directors

Chapter 1: Formation of the Board

Article 16: Composition of the Board

The following shall be taken into consideration when composing the Board:

- 1) the number of its members shall be suitable for the size and nature of the Company's activities without prejudice to paragraph (a) of Article 17 of these Regulations.
- 2) the majority of the Board members shall be of Non-Executive Directors.
- 3) the number of Independent Directors shall not be less than two members or one-third of the Board members, whichever is greater.

Article 17: Appointment of the Board members Board

- a) The Company's bylaws shall specify the number of the Board members, provided that such number shall not be less than three and not more than eleven.

b) The General Assembly shall elect the Board members for the term stated in the Company's bylaws, provided that such term shall not exceed three years. Board members may be re-elected, unless otherwise provided for in the Company's bylaws.

c) A Board member shall not be a member of the Boards of Directors of more than five listed joint stock companies at the same time.

d) The Company shall notify the Authority of the names of the Board members and description of their memberships within five business days from the commencement date of the Board term or from the date of their appointment ,whichever is shorter,, as well as any changes that may affect their membership within five business days from the occurrence of such changes.

Article 18: Conditions for the membership of the Board1

A member of the Board is required to be professionally capable and has the required experience, knowledge, skill and independence, which enable him/her to perform his/her duties efficiently. He/she shall have the following qualifications in particular:

1) **Ability to lead:** He/she shall enjoy leadership skills which enable him/her to delegate powers in order to enhance performance and apply best practices in effective management and compliance with professional ethics and values.

2) **Competency:** He/she shall have the academic qualifications and proper professional and personal skills as well as an appropriate level of training and practical experience related to the current and future businesses of the Company and the knowledge of management, economics ,accounting, law or governance, as well as the desire to learn and receive training.

3) **Ability to guide:** He/she shall have the technical, leadership, and administrative competencies as well as the ability to take prompt decisions, and understand technical

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requirements and developments related to the job. He/she shall also be able to provide strategic guidance and long-term planning and have a clear future vision.

- 4) **Financial knowledge:** He/she shall have the ability to read and understand financial statements and reports.
- 5) **Physical fitness:** He/she shall not suffer from any health issue that may hinder him/her from performing his/her duties and responsibilities.

The General Assembly shall take into account, when electing members to the Board, the recommendations of the nomination committee and the availability of the personal and professional capabilities required to perform their duties effectively pursuant to this Article.

Article 19: Termination of a Board Membership

- a) The Company's bylaws shall specify the manner by which membership of the Board may be terminated. At all times, the Ordinary General Assembly may dismiss all or any of the Board members, even if the Company's bylaws provides for otherwise, without prejudice to the dismissed member's right for compensation if the dismissal was on an unacceptable reason or at inappropriate time. The General Assembly may also, s per a recommendation of the Board, terminate the membership of the member who missed three consecutive meetings without a legitimate excuse.
- b) Upon the termination of the membership of a Board member by any termination method, the Company shall promptly notify the Authority and the Exchange and shall specify the reasons for such termination.
- c) If a member of the Board resigns and has comments on the performance of the Company, he/she shall submit a written statement explaining such comments to the chairman of the Board and such statement shall be presented to the Board members.

Article 20: Issues Affecting Independence

- a) An Independent Director shall be able to perform his/her duties, express his/her opinions and vote on decisions objectively with no bias in order to help the Board make correct decisions that contribute to achieving the interests of the Company.
- b) The Board shall annually evaluate the extent of the member's independence and ensure that there are no relationships or circumstances that affect or may affect his/her independence.

c) By way of example, the following negate the independence requirement for an Independent Director:

- 1) if he/she holds five percent or more of the shares of the Company or any other company within its group; or is a relative of who owns such percentage.
- 2) if he/she is a representative of a legal person that holds five percent or more of the shares of the Company or any company within its group;
- 3) if he/she is a relative of any member of the Board of the Company, or any other company within the Company's group;
- 4) if he/she is a relative of any Senior Executive of the Company, or of any other company within the Company's group;
- 5) if he/she is a Board member of any company within the group of the Company for which he/she is nominated to be a Board member.
- 6) if he/she is an employee or used to be an employee, during the preceding two years, of the Company, of any party dealing with the Company or any company within its group, such as external auditors or main suppliers; or if he/she, during the preceding two years, held a controlling interest in any such parties;
- 7) if he/she has a direct or indirect interest in the businesses and contracts executed for the Company's account;
- 8) if the member of the Board receives financial consideration from the Company in addition to the remuneration for his/her membership of the Board or any of its committees;
- 9) if he/she engages in a business where he competes with the Company, or conducting businesses in any of the company's activities.
- 10) if he/she served for more than nine years, consecutive or inconsecutive, as a Board member of the Company.²

Chapter 2: Responsibilities and Competencies of the Board

Article 21: Responsibility of the Board

- a) The Board represents all shareholders; it shall perform its duties of care and loyalty in managing the Company's affairs and undertake all actions in the general interest of the Company and develop it and maximise its value.
- b) The Board is responsible for the Company's business even if it delegates some of its powers to committees, individuals or other third parties. In any case, the Board may not issue a general or an open-ended delegation.

Article 22: Main Functions of the Board

Without prejudice to the competencies of the General Assembly as per the Companies Law and Its Implementing Regulations and the Company's bylaws, the Board shall have the broadest powers in managing the Company and guiding its activities to achieve its objectives. Among the main functions and competencies of the Board are the following:

- 1) laying down the plans, policies, strategies and main objectives of the Company; supervising their implementation and reviewing them periodically; . And, ensuring that the human and financial resources required to fulfill them are available, including:
 - a. setting a comprehensive strategy for the Company, key business plans and policies and mechanisms of the risk management and review and guide them
 - b. determining the most appropriate capital structure for the Company, its strategies and financial objectives, and approving all kinds of estimated budgets;
 - c. overseeing the main capital expenditures of the Company and the acquisition or disposal of assets;
 - d. setting performance indicators, and monitoring the implementation thereof and the overall performance of the Company;

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- e. reviewing and approving the organisational and human resources structures of the

Company on a periodic basis; and

- f. ensuring that the financial and human resources required for achieving the objectives and main plans of the Company are available.

2) setting rules and procedures for internal control and generally overseeing them, including:

- a. developing a written policy to remedy actual and potential conflicts of interest scenarios for each of the Board members, the Executive Management, and the shareholders. This includes misuse of the Company's assets and facilities and the mismanagement resulting from transactions with Related Parties;

- b. ensuring the integrity of the financial and accounting rules, including rules relating to the preparation of financial reports;

- c. ensuring the implementation of appropriate control procedures for risk assessment and management by generally forecasting the risks that the Company may encounter and creating an environment which is aware of the culture of risk management at the Company level and disclosing such risks transparently to the

Stakeholders and parties related to the Company ; and

- d. reviewing the effectiveness of the Company's internal control procedures on an annual basis.

3) setting forth specific and explicit policies, standards and procedures for membership in the Board, without prejudice to the mandatory provisions of these Regulations, and implementing them following approval by the General Assembly;

4) developing a written policy that regulates the relationship with Stakeholders pursuant to the provisions of these Regulations;

5) setting policies and procedures to ensure the Company's compliance with the laws and regulations and the Company's obligation to disclose

material information to shareholders and Stakeholders, and ensuring the compliance of the Executive Management with these policies and procedures;

6) supervising the management of the Company's finances, its cash flows as well as its financial and credit relationships with third parties;

7) providing recommendations to the Extraordinary General Assembly as to what it deems appropriate regarding the following:

- a. increasing or decreasing the share capital of the Company; and
- b. dissolving the Company before the end of its term as specified in its bylaws or deciding the continuity of the Company.

8) providing recommendation to the Ordinary General Assembly as to what it deems appropriate regarding:

- a. using the consensual reserve of the Company, if such has been formed by the

Extraordinary General Assembly and has not been allocated to a specific purpose;

- b. forming additional financial allocations or reserves for the Company; and

- c. the method of distributing the net profits of the Company.

9) preparing the Company's interim and annual financial statements and approving them before publishing them;

10) preparing the Board report and approving it before publishing it.

11) ensuring the accuracy and integrity of the data and information which must be disclosed pursuant to the applicable policies and systems in respect of disclosure and transparency;

12) developing effective communication channels allowing shareholders to continuously and periodically review the various aspects of the Company's businesses as well as any material developments;

13) forming specialised committees of the Board pursuant to resolutions that shall specify the term, powers and responsibilities of such committees as well as the manner used by the Board to monitor such committees. Such resolutions

shall also specify the names of the members and their duties, rights and obligations and shall evaluate the performance and activities of these committees and their members;

14) specifying the types of remunerations granted to the Company's employees, such as fixed remunerations, remunerations linked to performance and remunerations in the form of shares without prejudice to the Regulatory Rules and Procedures issued pursuant to the Companies Law related to Listed Joint Stock Companies; 15) setting the values and standards that govern the work at the Company;

Article 23: Distribution of Competencies and Duties

The organisational structure of the Company shall specify the competencies and distribute the duties between the Board and the Executive Management in accordance with the best practices in Corporate Governance, and to improve the efficiency of the Company's decision making and to achieve a balance of powers and authorities across the Board and the Executive Management, and to achieve this, the Board shall:

- 1) approve and develop internal policies in respect of the Company's business, including specifying the duties, competencies and responsibilities assigned to the various organisational levels;
- 2) approving a written and detailed policy that identifies the powers delegated to the Executive Management, a matrix stating these powers, means of implementation and the period of delegation\ The Board may request the Executive Management to submit periodic reports in respect of its exercise of such delegated powers; and 3) identifying the matters on which the Board reserves the power to decide.

Article 24: Separation of Positions

- a) without prejudice to the provisions of the Company's bylaws, The Board appoints a chairman, a vice chairman and may appoint a managing director of its members.
- b) it is prohibited to hold, at the same time, the position of chairman of the Board and any other executive position in the Company, including the positions of the

managing director, the Chief Executive Officer, or the general manager, even if the Company's bylaws provided for otherwise.

c) the Board shall define the competencies and specify the responsibilities of the chairman, the vice chairman, and the managing director (if any) explicitly and in writing if the Company's bylaws has no reference thereto.

d) in all cases, no person shall have the sole and absolute power to take decisions in the Company.

Article 25: Oversight over the Executive Management

The Board shall form the Executive Management of the Company, regulate its operating procedures, monitor and oversee it and ensure that it performs the duties assigned to it, and to achieve this, the Board shall:

- 1) develop the necessary administrative and financial policies;
- 2) ensure that the Executive Management operates in accordance with the policies approved by the Board.;
- 3) select and appoint the Chief Executive Officer of the Company, and oversee his/her work;
- 4) appoint the manager of the internal audit unit or department, or the internal auditor and dismiss him and determine his remuneration, if any;
- 5) convene periodic meetings with the Executive Management to explore the work progress and any obstacles and problems in connection therewith, and review and discuss the important information in respect of the Company's business;
- 6) develop standards for the performance of the Executive Management consistent with the objectives and strategy of the Company;
- 7) review and evaluate the performance of the Executive Management; and
- 8) develop succession plans for the management of the Company.

Article 26: Competencies and Duties of the Executive Management

Without prejudice to the competencies entrusted to the Board pursuant to the provisions of the Companies Law and Its Implementing Regulations, the Executive Management

shall be responsible for implementing the plans, policies, strategies and main objectives of the Company in order to achieve its purposes. The competencies and duties of the Executive Management shall include the following:

- 1) implementing the Company's internal policies and rules approved by the Board;
- 2) suggesting the Company's comprehensive strategy as well as the principal and interim business plans and the policies and mechanisms for investment, financing, risk management and emergency administrative circumstances management plans and implementing them;
- 3) proposing the most appropriate capital structure for the Company and its strategies and financial objectives;
- 4) proposing the main capital expenditures of the Company and acquiring and disposing of assets;
- 5) proposing the organisational and human resources structures of the company and presenting them to the Board for approval;
- 6) implementing internal control systems and procedures, and generally overseeing them, which include:
 - a. implementing the conflicts of interest policy;
 - b. correctly applying the financial and accounting procedures, including the procedures relating to the preparation of financial reports;
 - c. applying appropriate control systems for measuring and managing risks by generally forecasting the risks that the Company may encounter and creating an environment which is aware of the culture of risk mitigation at the Company level, and transparently disclosing them to the Company's Board and other Stakeholders.
- 7) implementing the Company's Corporate Governance rules effectively, to the extent they do not conflict with the provisions of these Regulations, and proposing amendments thereto if needed;

- 8) implementing policies and procedures to ensure the Company's compliance with the laws and regulations and its obligation to disclose material information to shareholders and Stakeholders;
- 9) providing the Board with the information required to exercise its competencies and provide recommendations regarding the following:
 - a. increasing or decreasing the share capital of the Company;
 - b. dissolving the Company before the end of its term as specified in its bylaws or deciding the continuity of the Company;
 - c. using the consensual reserve of the Company;
 - d. forming additional reserves for the Company; and
 - e. the method for distributing the net profits of the Company.
- 10) proposing the policy and types of remunerations granted to employees, such as fixed remunerations, remunerations linked to performance and remunerations in the form of shares;
- 11) preparing periodic financial and non-financial reports in respect of the progress achieved in the business of the Company in light of the strategic plans and objectives of the Company, and presenting such reports to the Board;
- 12) managing the daily business and activity of the Company, in addition to managing its resources in the most appropriate form in accordance with the objectives and strategies of the Company;
- 13) participating effectively in building and developing a culture of ethical values within the Company;
- 14) implementing internal control and risk management systems and ensuring that they are effective and efficient, and ensuring compliance with the level of risks approved by the Board;
- 15) proposing and developing internal policies related to the business of the Company, including specifying the duties, competencies and responsibilities assigned to the various organisational levels;

16) proposing a clear policy to delegate tasks to the Executive Management and the method for implementing such policy; and

17) proposing the powers to be delegated to the Executive Management, the procedures for decision making and the period of delegation, provided that it shall present periodic reports to the Board in respect of its exercise of such powers.

Chapter 3: Competencies of the Chairman and the Board Members

Article 27: Competencies and Duties of the Chairman of the Board

Without prejudice to the competencies of the Board, the chairman of the Board shall be responsible for leading the Board and supervising its operations and the effective performance of its duties. The competencies and duties of the chairman of the Board shall in particular include the following:

- 1) ensuring that the Board members obtain complete, clear, accurate and nonmisleading information in due course;
- 2) ensuring that the Board effectively discusses all fundamental issues in due course;
- 3) representing the Company before third parties in accordance with the Companies Law and Its Implementing Regulations and the Company's bylaws;
- 4) encouraging the Board members to effectively perform their duties in order to achieve the interests of the Company;
- 5) ensuring that there are actual communication channels with shareholders and conveying their opinions to the Board;
- 6) encouraging constructive relationships and effective participation between the Board and the Executive Management on the one hand, and the Executive, Non-Executive and Independent Directors on the other hand, and creating a culture that encourages constructive criticism;
- 7) preparing agendas of the Board meetings, taking into consideration any matters raised by Board members or the external auditor and consult with the Board members and the Chief Executive Officer upon preparing the Board's agenda; and

8) convening periodic meetings with the Non-Executive Directors without the presence of any executive officers of the Company.

9) notifying the Ordinary General Assembly while convening of the businesses and contracts in which any Board member has direct or indirect interest, the notification shall include the information provided by the member to the Board as per paragraph (14) of Article (30) of these Regulations; this notification shall be accompanied by a special report of the Company's external auditor.

Article 28: Appointing the Chief Executive Officer after the end of his/her services as Chairman of the Board

It is prohibited to appoint the Chief Executive Officer, during the first year following the end of his/her service, as the chairman of the Board.

Article 29: Principles of truthfulness, honesty and loyalty

Each member of the Board shall comply with the principles of truthfulness, honesty, loyalty, and care of the interests of the Company and its shareholders, and prioritise their interests over his/her personal interests. This shall include, in particular, the following:

1) **Truthfulness:** is achieved when the relationship between the Board member and the Company is an honest professional relationship, and he/she discloses to the Company any significant information before entering into any transaction or contract with the Company or any of its affiliates.

2) **Loyalty:** is achieved when the Board member avoids transactions that may entail conflicts of interest and ensures fairness of dealing, in compliance with the provisions relating to conflicts of interest in these Regulations.

3) **Care:** is achieved by performing the duties and responsibilities set forth in the Companies Law, the Capital Market Law and their implementing regulations and the Company's bylaws and other relevant laws.

Article 30: Tasks and Duties of the Board Members

Each member of the Board shall, being a Board member, perform the following tasks and duties:

- 1) providing proposals to develop the strategy of the Company;
- 2) monitoring the performance of the Executive Management and the extent to which it has achieved the objectives and purposes of the Company;
- 3) reviewing reports related to the performance of the Company;
- 4) ensuring the integrity and impartiality of the financial statements and information of the Company;
- 5) ensuring that the financial control and risk management systems are sound;
- 6) determining the appropriate level of remunerations of the members of the Executive Management;
- 7) expressing opinions as to the appointment and dismissal of members of the Executive Management;
- 8) participating in developing the succession and replacement plans of executive positions within the Company;
- 9) complying fully with the provisions of the Companies Law, Capital Market Law, their implementing regulations, the relevant regulations and the bylaws when performing his/her duties as a member of the Board and abstaining from taking or participating in any action that constitute mismanagement of the Company's affairs;
- 10) attending the Board and the General Assembly meetings, and not being absent except for legitimate excuse of which the chairman of the Board shall be notified by prior notice, or for emergency reasons;
- 11) allocating sufficient time to fulfill his/her responsibilities and preparing for the Board and its committees meetings and effectively participating therein, including raising relevant questions and carrying discussions with the Senior Executives;
- 12) studying and analysing all information related to the matters looked into by the Board before expressing an opinion on the same;

- 13) enabling other Board members to express their opinions freely, and encouraging the Board to deliberate on the subjects and obtain the views of the competent members of the Company's Executive Management and others, when necessary;
- 14) notifying the Board fully and immediately of any interest, either direct or indirect, in the businesses and contracts that are executed for the Company's account, the notification shall include the nature and extent of such interest, the names of concerned persons, and the expected benefit to be obtained directly or indirectly from interest whether financial or non-financial. the concerned member shall abstain from voting on any decisions issued in connection therewith in compliance with the provisions of the Companies Law, the Capital Market Law and their implementing regulations;
- 15) notifying the Board fully and immediately of his/her participation, directly or indirectly, in any businesses that may compete with the Company or lead to competing with the Company, directly or indirectly, in respect of any of its activities, in compliance with the provisions of the Companies Law, the Capital Market Law and their implementing regulations;
- 16) refraining from disclosing or announcing any secrets he/she came across through his/her membership in the Board to any shareholder of the Company, unless such disclosure is made during the meetings of the General Assembly, or to a third party, in pursuance with the provisions of the Companies Law, the Capital Market Law and their implementing regulations;
- 17) working on the basis of complete information, in good faith and with the necessary care and diligence for the interest of the Company and all shareholders;
- 18) recognising his/her duties, roles and responsibilities arising from the membership;
- 19) developing his/her knowledge in the field of the Company's business and activities and in the related financial, commercial and industrial fields; and
- 20) resigning from the membership of the Board if he/she is unable to fully fulfill his/her duties in the Board.

Article 31: Duties of the Independent Director

Without prejudice to Article (30) of these Regulations, an Independent Director of the Board shall effectively participate in the following duties:

- 1) expressing his/her independent opinion in respect of strategic issues and the Company's policies and performance and appointing members of the Executive Management;
- 2) ensuring that the interest of the Company and its shareholders are taken into account and given priority in case of any conflicts of interest;
- 3) overseeing the development of the Company's Corporate Governance rules, and monitoring the implementation of the rules by the Executive Management.

Chapter 4: Procedures of the Board Activities

Article 32: The Board Meetings

- a) Without prejudice to the Companies Law and Its Implementing Regulations, the Board shall convene regular meetings to perform its duties effectively, and also convene meetings whenever needed.
- b) The Board shall convene no less than four meetings per year, and no less than one meeting every three months.³
- c) The Board shall meet upon the invitation of its chairman or upon a request from two of its members. The invitation to the meeting shall be sent to each of the Board members no less than five days prior to the date of the meeting accompanied by its agenda and the necessary documents and information, unless circumstance require convening an emergency meeting, the invitation accompanied with the agenda and necessary documents and information may be sent within a period less than the five days.
- d) The meeting shall not be valid unless attended by half of the Board members, provided that the number of attendees shall not be less than three, unless the Company's bylaws stated greater percentage or number.

Article 33: Remarks of the Board Members

- a) If any member of the Board has any remarks in respect of the performance of the Company or any of the matters presented and which was not resolved in the Board meeting, such remarks shall be recorded and the procedures taken or to be taken by the Board in connection therewith must be set forth in the minutes of the Board meeting.
- b) If a member of the Board expresses an opinion differs from the Board resolution, such opinion must be recorded in detail in the minutes of the Board meeting.

Article 34: Organising the Attendance of the Board Meetings.

- a) The Attendance of Board meetings, and dealing with cases of irregular attendance by members of such meetings shall be organised.
- b) An Independent Director of the Board shall make every effort to attend all meetings in which important and material decisions affecting the position of the Company are made.

Article 35: The Agenda of Board Meetings

- a) The Board shall approve the agenda once the Board meeting is convened. Should any member of the Board raise any objection in respect of such agenda, such objection shall be recorded in the minutes of the meeting.
- b) Each member of the Board is entitled to propose additional items to the agenda.

Article 36: Exercising the Competencies of the Board

- a) The Board shall exercise its competencies and duties to lead the Company within a framework of effective and prudent controls that allow assessing and managing risks and limiting and mitigating their effects.
- b) Without prejudice to Paragraph (b) of Article (21) of these Regulations, the Board may, within the scope of its competencies, delegate to one or more of its members or committees or a third party the performance of a specific function or functions.

c) The Board shall develop an internal policy that explains the procedures of the Board activities and aims at encouraging its members to work effectively to fulfill their obligations towards the Company.

d) The Board shall organise its activities and allocate sufficient time to perform the duties and responsibilities assigned to it, including preparing for Board and committees meetings and ensuring the coordination, recording and retaining of the minutes of its meetings.

Article 37: The Secretary of the Board

a) The Board shall appoint a secretary among its members or a third party, whose competencies and remunerations shall be specified by a Board resolution, unless the Company's bylaws include provisions in connection therewith, provided that such powers shall include:

- 1) documenting the Board meetings and preparing minutes therefor, which shall include the discussions and deliberations carried during such meetings, as well as the place, date, times on which such meetings commenced and concluded; and recording the decisions of the Board and voting results and retaining them in a special and organised register, and including the names of the attendees and any reservations they expressed (if any),. Such minutes shall be signed by all of the attending members;
- 2) retaining the reports submitted to the Board and the reports prepared by it;
- 3) providing the Board members with the agenda of the Board meeting and related worksheets, documents and information and any additional information, related to the topics included in the agenda items, requested by any Board member;
- 4) ensuring that the Board members comply with the procedures approved by the Board;
- 5) notifying the Board members of the dates of the Board's meetings within sufficient time prior to the date specified for the meeting;

- 6) presenting the draft minutes to the Board members to provide their opinions on them before signing the same;
 - 7) ensuring that the Board members receive, fully and promptly, a copy the minutes of the Board's meetings as well as the information and documents related to the Company;
 - 8) coordinating among the Board members;
 - 9) regulating the disclosure register of the Board and Executive Management as per Article (92) of these Regulations; and
 - 10) providing assistance and advice to the Board members.
- b) The Secretary of the Board may not be dismissed except pursuant to a decision of the Board.

Article 38: Qualifications of the Secretary⁴

The Board must specify the conditions that the secretary must meet, provided that they include at least one of the following:

- 1) he/she holds a bachelor degree in law, finance, accounting or administration or their equivalent, and has relevant practical experience of not less than three years; or
- 2) he/she has relevant practical experience of not less than five years.

Chapter 5: Training, Support and Assessment

Article 39: Training⁵

The Company shall pay adequate attention to the training and preparation of the Board members and the Executive Management, and shall develop the necessary programmes required for the same, taking the following into account:

- 1) preparing programmes for the recently-appointed Board members and Executive Management to familiarise them with the progress of the Company's business and activities, particularly the following:
 - a. the strategy and objectives of the Company;
 - b. the financial and operational aspects of the Company's activities;

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- c. the obligations of the Board members and their duties, responsibilities and rights;
- d. the duties and competencies of the committees of the Board.

2) developing the necessary mechanisms for Board members and the Executive Management to continuously enroll in training programmes and courses in order to develop their skills and knowledge in the fields related to the activities of the Company.

Article 40: Providing Members with Information

The Executive Management of the Company shall provide the Board members, the NonExecutive Directors in particular, and the committees of the Company with all of the necessary information, details, documents and records, provided that they shall be complete, clear, correct and non-misleading, in due course to enable them to perform their duties and obligations.

Article 41: The Assessment⁶

- a) The Board shall develop, based on the proposal of the nomination committee, the necessary mechanisms to annually assess the performance of the Board, its members and committees and the Executive Management using key performance indicators linked to the extent to which the strategic objectives of the Company have been achieved, the quality of the risk management and the efficiency of the internal control systems, among others, provided that weaknesses and strengths shall be identified and a solution shall be proposed for the same in the best interests of the Company.
- b) The procedures of performance assessment shall be in writing and clearly stated and disclosed to the Board members and parties concerned with the assessment.
- c) The performance assessment shall entail an assessment of the skills and experiences of the Board, identification of the weaknesses and strengths of the Board and shall attempt to resolve such weaknesses using the available methods, such as nominating competent professional staff able to improve the performance

of the Board. The performance assessment shall also entail the assessment of the mechanisms of the Board's activities in general.

d) The individual assessment of the Board members shall take into account the extent of effective participation of the member and his/her commitment to performing his/her duties and responsibilities, including attending the Board and its committees meetings and dedicating adequate time thereof.

e) The Board shall carry out the necessary arrangements to obtain an assessment of its performance from a competent third party every three years.

f) Non-Executive Directors shall carry out a periodic assessment of the performance of the chairman of the Board after getting the opinions of the Executive Directors, without the presence of the chairman of the Board in the discussion on this matter, provided that weaknesses and strengths shall be identified and a solution shall be proposed for the same in the best interests of the Company.

Chapter 6: Conflicts of Interest

Article 42: Dealing with Conflicts of Interest and Related Parties Transactions

Without prejudice to the provisions of the Companies Law and Its Implementing Regulations, conflicts of interest situations and Related Parties transactions shall be dealt with in accordance with the provisions of this Chapter.

Article 43: Conflicts of Interest Policy

The Board shall develop an explicit and written policy to deal with actual and potential conflicts of interest situations which may affect the performance of Board members, the Executive Management or any other employees of the Company when dealing with the Company or other Stakeholders. This policy shall include the following in particular:

- 1) informing Board members, Substantial Shareholders, Senior Executives and other employees of the Company of the importance of avoiding situations that may lead to a conflict between their interests and the interests of the Company, and dealing with them in accordance with the provisions of the Companies Law and Its Implementing Regulations.

- 2) providing examples of conflicts of interest situations that are relevant to the nature of the Company's activity.
- 3) clear procedures for disclosing conflicts of interest and obtaining authorisation or the requisite approval prior to commencing the activities that may lead to conflicts of interest.
- 4) the obligation to constantly disclose situations that may lead to conflicts of interest or upon the occurrence of such conflicts.
- 5) the obligation to abstain from voting or taking part in decision making when there is conflicts of interest.
- 6) clear procedures when the Company contracts or enters into a transaction with a Related Party, this shall include notifying the Authority and the public without any delay of that contract or transaction if it equals to or exceeds 1% of the Company's total revenues according to the last annual audited financial statements.
- 7) procedures to be taken by the Board when discovering that such policy is violated.

Article 44: Avoiding Conflicts of Interest

- a) A member of the Board shall:
 - 1) perform his/her duties with honesty and integrity, and prioritise the interests of the Company over his/her own interest, and not use his/her position to achieve personal interests;
 - 2) avoid situations of conflicts of interest and notify the Board of situations of conflict which may affect his/her neutrality when looking into matters presented before the Board. The Board shall not allow such member to be involved in deliberations and shall not count his/her vote when voting on such matters in the

Board and the Shareholders Assemblies meetings; and

- 3) protect the confidentiality of the information related to the Company and its activities, and not disclose any of such information to any person.

b) Each Board member is prohibited from:

- 1) voting on a decision taken by the Board or the General Assembly with respect to transactions and contracts that are executed for the Company's account, if he/she has a direct or indirect interest therein.
- 2) misusing or benefitting, directly or indirectly, from any of the Company's assets, information or investment opportunities presented to the Company or to him in his/her capacity as a member of the Board. This includes investment opportunities which are within the activities of the Company, or which the Company wishes to make use of. Such prohibition shall extend to Board member who resigns to, directly or indirectly, use investment opportunities that the Company wishes to use, which came to his/her knowledge during his/her membership in the Board.

Article 45: Disclosure of Conflicts of Interest by the Nominee

A person who desires to nominate himself/herself for the membership of the Board shall disclose to the Board or the General Assembly any cases of conflicts of interest, including:

- 1) having direct or indirect interest in the contracts and businesses entered into for the benefit of the Company in which he/she desires to be nominated to the Board.
- 2) engaging in business that may compete with the Company or any of its activities.

Article 46: Competing with the Company

Without prejudice to Article (72) of the Companies Law, if a member of the Board desires to engage in a business that may compete with the Company or any of its activities, the following shall be taken into account:

- 1) notifying the Board of the competing businesses he/she desires to engage in and recording such notification in the minutes of the Board meeting.
- 2) the conflicted member shall abstain from voting on the related decision in the Board meeting and General Assemblies.

- 3) the chairman of the Board informing the Ordinary General Assembly, once convened, of the competing businesses that the member of the Board is engaged in.
- 4) obtaining a prior authorisation of the Ordinary General Assembly of the Company for the member to engage in the competing business, provided that such authorisation shall be renewed annually.

Article 47: Concept of the Competing Businesses

The following shall be deemed a participation in any business that may compete with the Company or any of its activities:

- 1) the Board members' establishing a company or a sole proprietorship or the ownership of a controlling percentage of shares or stakes in a Company or any other entity engages in business activities that are similar to the activities of the Company or its group.
- 2) accepting membership in the Board of a company, an entity that competing with the Company or its group, or managing the affairs of a competing sole proprietorship or any competing company of any form.
- 3) the Board member's acting as an overt or covert commercial agent for another company or entity competing with the Company or its group.

Article 48: Rejecting the Renewal of Authorisation

If the General Assembly rejects renewing the authorisation granted pursuant to Articles (71) and (72) of the Companies Law and Article (46) of these Regulations, the member of the Board shall resign within a period specified by the General Assembly; otherwise, his/her membership in the Board shall be deemed terminated, unless he/she decides to withdraw from such contract, transaction or competing venture or regularise his/her situation in accordance with the Companies Law and its Implementing Regulations prior to the end of the period set by the General Assembly.

Article 49: Accepting Gifts

No member of the Board or Senior Executives may accept gifts from any person who has entered into commercial transactions with the Company if such acceptance of gifts may lead to a conflicts of interest.

PART 4: Company Committees

Chapter 1: General Provisions

Article 50: Forming the Committees

Without prejudice to Article (101) of the Companies Law and Article (54) of these Regulations , the Board shall form specialised committees as follows:

1. as may be needed depending on the Company's circumstances in order to enable it to effectively perform its duties.
2. the formation of the committees shall be made in accordance with general procedures developed by the Board, which shall determine the duties, duration and powers of each committee, and the manner in which the Board monitors the activities of each committee. The committee shall inform the Board of its findings or decisions with complete transparency. The Board shall regularly follow up the activities of such committees to ensure the performance of the duties delegated to them.
3. each committee shall be responsible before the Board for its activities, this shall not relieve the Board of its responsibility for such activities, duties and powers that it has delegated to such committee.
4. the number of members of a committee shall not be less than three or more than five.
5. the chairmen or whom they delegate of each committee members, shall attend the General Assembly Meetings and answer any questions raised by the shareholders.
6. the Company shall provide the Authority with the names of the members and the types of their memberships in such Board's committees within five (5) days of their appointment, and shall notify the Authority of any changes thereto within five (5) days of the date of such changes.
7. a Company may combine remuneration and nomination committees into one committee named remuneration and nomination committee. In such case, the remuneration and nomination committee must satisfy the requirements related to any of them as set forth in Chapter 3 and 4 of this Part, and exercise all the powers

set forth in Article (61) and (65) of these Regulations, provided that the committee convenes periodically at least every six months.

Article 51: Committees Membership

a) A sufficient number of Non-Executive Directors shall be appointed to the committees which perform duties that may involve a conflicts of interest, such as ensuring the integrity of financial and non-financial reports, reviewing Related Party transactions, nomination to membership of the Board, appointment of Senior Executives and determining the remuneration. Chairmen and members of these committees shall comply with principles of truthfulness, honesty, loyalty, and care and shall attend to the interests of the Company and its shareholders, and prioritise them over their personal interests.

b) The Company shall take into consideration while forming the remuneration and nomination committees that their members are of Independent Directors. The Board may appoint Non-Executive Directors or persons other than Board members either from shareholders or others, provided that the chairmen of committees mentioned in this paragraph are of the Independent Directors.

c) Chairman of the Board shall not be a member of the audit committee. He may be a member of other committees, provided that he is not the chairman of committees mentioned in these Regulations.

Article 52: Studying Subjects

a) Each committee shall assess the matters that fall within its authority or those referred to it by the Board and shall communicate its recommendations to the Board to issue decisions in connection therewith. The committees shall take decisions in regards to these matters if delegated by the Board, in pursuance to paragraph (b) of Article (21) of these Regulations.

b) The committees may seek assistance from any experts or specialists, whether internal or external, within the scope of its powers. This shall be included in the minutes of the committee meeting; the minutes states the name of the expert and his relation to the Company or its Executive Management.

Article 53: Committees Meetings

- a) No member of the Board or the Executive Management except the secretary or a member of the committee may attend the meetings of a committee unless such committee requests his/her opinion or advice.
- b) Committee meetings are valid if attended by a majority of its members. Resolutions of the committees shall be issued by a majority of the votes present and, in case of a tie, the chairman of the relevant committee shall have the casting vote.
- c) Board meetings shall be documented and minutes including the discussions and deliberations carried during such meetings shall be prepared. Recommendations of the committees and voting results shall be documented and retained in a special and organised register, including the names of the attendees and any reservations they expressed (if any). Such minutes shall be signed by all of the attending members.

Chapter 2: The Audit Committee Article 54: Audit Committee Formation

- a) An audit committee shall be formed by a resolution of the Company's Ordinary General Assembly, and the members of the audit committee shall be from the shareholders or others, provided that at least one of its members is an Independent Director and that no Executive Director is among its members. The number of the members of the audit committee shall not be less than three or more than five, provided that one of its member is specialised in finance and accounting.
- b) The chairman of the audit committee shall be an Independent Director.⁷
- c) The Company's General Assembly shall, upon a recommendation of the Board, issue a regulation for the audit committee which shall include the rules and procedures for the activities and duties of the committee, the rules for selecting its members, the means of

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their nomination, the term of their membership, their remunerations, and the mechanism of appointing temporary members in case a seat in the committee becomes vacant.

- d) Any person who works or has worked in the Company's finance Department, the Executive Management or for the Company's external auditor during the preceding two years may not be a member of the audit committee.

Article 55: Competencies, powers and responsibilities of the Audit Committee

The audit committee shall be competent in monitoring the Company's activities and ensuring the integrity and effectiveness of the reports, financial statements and internal control systems. The duties of the audit committee shall particularly include the following:

a) Financial Reports:

- 1) analysing the Company's interim and annual financial statements before presenting them to the Board and providing its opinion and recommendations thereon to ensure their integrity, fairness and transparency;
- 2) providing its technical opinion, at the request of the Board, regarding whether the Board's report and the Company's financial statements are fair, balanced, understandable, and contain information that allows shareholders and investors to assess the Company's

financial position, performance, business model, and strategy;

- 3) analysing any important or non-familiar issues contained in the financial reports;
- 4) accurately investigating any issues raised by the Company's chief financial officer or any person assuming his/her duties or the Company's compliance officer or external auditor;
- 5) examining the accounting estimates in respect of significant matters that are contained in the financial reports; and
- 6) examining the accounting policies followed by the Company and providing its opinion and recommendations to the Board thereon. **b) Internal Audit:**

- 1) examining and reviewing the Company's internal and financial control systems and risk management system;
- 2) analysing the internal audit reports and following up the implementation of the corrective measures in respect of the remarks made in such reports; and
- 3) monitoring and overseeing the performance and activities of the internal auditor and internal audit department of the company, if any, to ensure the availability of

the necessary resources and their effectiveness in performing the assigned activities and duties. If the Company has no internal auditor, the committee shall provide a recommendation to the Board on whether there is a need to appoint an internal auditor.

4) providing a recommendation to the Board on appointing the manager of the internal audit unit or department, or the internal auditor and suggest his/her remunerations. **c) External Auditor:**

1) providing recommendations to the Board to nominate external auditors, dismiss them, determine their remunerations, and assess their performance after verifying their independence and reviewing the scope of their work and the terms of their contracts;

2) verifying the independence of the external auditor, its objectivity, fairness, and effectiveness of the audit activities, taking into account the relevant rules and standards;

3) reviewing the plan of the Company's external auditor and its activities, and ensuring that it does not provide any technical or administrative works that are beyond its scope of work, and provides its opinion thereon;

4) responding to queries of the Company's external auditor; and

5) reviewing the external auditor's reports and its comments on the financial statements, and following up the procedures taken in connection therewith. **d)**

Ensuring Compliance:

1) reviewing the findings of the reports of supervisory authorities and ensuring that the Company has taken the necessary actions in connection therewith;

2) ensuring the Company's compliance with the relevant laws, regulations, policies and instructions;

3) reviewing the contracts and proposed Related Party transactions, and providing its recommendations to the Board in connection therewith; and

4) reporting to the Board any issues in connection with what it deems necessary to take action on, and providing recommendations as to the steps that should be taken.

Article 56: Conflict between the Audit Committee and the Board

If a conflict arises between the recommendations of the audit committee and the Board resolutions, or if the Board refuses to put the committee's recommendations into action as to appointing or dismissal the company's external auditor or determining its remuneration, assessing its performance or appointing the internal auditor, the Board's report shall include the committee's recommendations and justifications, and the reasons for not following such recommendations.

Article 57: Audit Committee Meetings

- a) The audit committee shall convene periodically, provided that at least four meetings are held during the Company's financial year.
- b) The audit committee shall convene periodically with the Company's external auditor and internal auditor, if any.
- c) The internal auditor and the external auditor may call for a meeting with the audit committee at any time as may be necessary.

Article 58: Arrangements for Providing Remarks

The audit committee shall develop arrangements that enable the Company's employees to confidentially provide their remarks in respect of any inaccuracies in the financial or other reports. The audit committee shall ensure that such arrangements have been put into action through an adequate independent investigation in respect of the error or inaccuracy, and shall adopt appropriate follow-up procedures.

Article 59: Powers of the Audit Committee

In order to perform its duties, the audit committee may:

- 1) review the Company's records and documents.
- 2) request any clarification or statement from the Board members or the Executive Management.
- 3) request that the Board calls for a General Assembly Meeting if its activities have been impeded by the Board or if the Company has suffered significant losses and damages.

Chapter 3: Remuneration Committee

Article 60: Composition of the Remuneration Committee

- a) The Company's Board shall, by resolution thereof, set up a committee to be named the “remuneration committee.” Members of the committee shall not be Executive Directors, provided that there shall be at least one Independent Director among them.
- b) The Company's General Assembly, as per the Board recommendation, issues a regulation for the remuneration committee including its procedure, duties and rules for selecting its members, the term of their membership and their remunerations.

Article 61: Competencies of the Remuneration Committee

The competences of the remuneration committee are:

- 1) preparing a clear policy for the remunerations of the Board members and its committees and the Executive Management, and presenting such policy to the Board in preparation for approval by the General Assembly, provided that such policy follows standards that linked to performance, and disclosing and ensuring the implementation of such policy;
- 2) clarifying the relation between the paid remunerations and the adopted remuneration policy, and highlighting any material deviation from that policy.
- 3) periodically reviewing the remuneration policy and assessing its effectiveness in achieving its objectives; and
- 4) providing recommendations to the Board in respect of the remunerations of its members, the committees members and Senior Executives, in accordance with the approved policy.

Article 62: Remuneration Policy

Without prejudice to the provisions of the Companies Law and the Capital Market Law and their implementing regulations, the remuneration policy shall:

- 1) be consistent with the Company's strategy and objectives;
- 2) provide remunerations with the aim of encouraging the Board members and Executive Management to achieve the success of the Company and its long-term

development, by for example making the variable part of the remuneration linked to the long-term performance;

3) determine remuneration based on job level, duties and responsibilities, educational qualifications, practical experience, skills and level of performance;

4) be consistent with the magnitude, nature and level of risks faced by the Company;

5) take into consideration the practices of other companies in respect of the determination of remunerations, and avoid the disadvantages of such comparisons in leading to

unjustifiable increases in remunerations and compensations;

6) attract talented professionals and retain and motivate them without exaggeration;

7) be prepared in coordination with the nomination committee in respect of new appointments;

8) take into consideration situations where remunerations should be suspended or reclaimed if it is determined that such remunerations were set based on inaccurate information provided by a member of the Board or the executive management, in order to prevent abuse of power to obtain unmerited remunerations; and

9) regulating the grant of Company's shares to the Board members and the Executive Management, whether newly issued or purchased by the Company.

Article 63: Meetings of the Remuneration Committee

The remuneration committee shall convene periodically at least once a year, and as may be necessary.

Chapter 4: Nomination Committee

Article 64: Composition of the Nomination Committee

a) The Company's Board shall, by resolution thereof, form a committee to be named the "nomination committee,". Members of the committee shall not be Executive Directors, provided that there shall be at least one Independent Director among them.

- b) The Company's General Assembly, as per the Board recommendation, issues a regulation for the nomination committee including its procedures, duties and rules for selecting its members, the term of their membership and their remunerations.

Article 65: competences of the Nomination Committee

The competences of the nomination committee shall include the following:

- 1) suggesting clear policies and standards for membership of the Board and the Executive Management;
- 2) providing recommendations to the Board for the nomination or re-nomination of its members in accordance with approved policies and standards, taking into account that nomination shall not include any person convicted of a crime involving moral turpitude or dishonesty;
- 3) preparing a description of the capabilities and qualifications required for membership of the Board and Executive Management positions;
- 4) determining the amount of time that the member shall allocate to the activities of the Board;
- 5) annually reviewing the skills and expertise required of the Board members and the Executive Management;
- 6) reviewing the structure of the Board and the Executive Management and providing recommendations regarding changes that may be made to such structure;
- 7) annually ensuring the independence of Independent Directors and the absence of any conflicts of interest if a Board member also acts as a member of the Board of directors of another company;
- 8) providing job descriptions for the Executive, Non-Executive and Independent Directors and the Senior Executive Management;
- 9) setting procedures to be followed if the position of a member of the Board or a Senior Executive becomes vacant; and
- 10) determining the strengths and weaknesses of the Board and recommending remedy solutions that serve the Company's interests.

Article 66: the Nomination Procedures

a) When nominating a Board member, the nomination committee shall take into consideration the provisions of these Regulations and the requirements set by the Authorities; and

b) The number of nominees to the Board whose names are presented to the General Assembly shall be more than the number of available seats to give a chance to the General Assembly to select the Board members among those nominees.⁸

Article 67: Meetings of the Nomination Committee

The nomination committee shall convene periodically at least once a year, and as may be necessary.

Article 68: Publishing the Nomination Announcement

The Company shall publish the nomination announcement on the websites of the Company and the Exchange and through any other medium specified by the Authority; to invite persons wishing to be nominated to the membership of the Board, provided that the nomination period shall remain open for at least a month from the date of the announcement.

Article 69: Nomination Rights of Shareholders

None of the provisions of this Chapter shall prejudice the right of any shareholder to nominate him/herself or others to the membership of the Board in accordance with the provisions of the Companies Law and Its Implementing Regulations.

Chapter 5: Risk Management Committee

Article 70: Composition of the Risk Management Committee⁹

The Company's Board shall, by resolution therefrom, form a committee to be named the "risk management committee." Chairman and majority of its members shall be Non-Executive Directors. The members of that committee shall possess an adequate level of knowledge in risk management and finance.

Article 71: Competencies of the Risk Management Committee¹⁰

The competences of the risk management committee shall include the following:

1) developing a strategy and comprehensive policies for risk management that are consistent with the nature and volume of the Company's activities, monitoring their implementation, and reviewing and updating them based on the Company's internal and external changing factors;

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2) determining and maintaining an acceptable level of risk that may be faced by the Company and ensuring that the Company does not go beyond such level;

3) Ensuring the feasibility of the Company continuation, the successful continuity of its activities and determining the risks that threaten its existence during the following twelve (12) months;

4) overseeing the Company's risk management system and assessing the effectiveness of the systems and mechanisms for determining and monitoring the risks that threaten the Company in order to determine areas of inadequacy therein;

5) Regularly reassessing the Company's ability to take risks and be exposed to such risks (through stress tests as an example);

6) preparing detailed reports on the exposure to risks and the recommended measures to manage such risks, and presenting them to the Board;

7) providing recommendations to the Board on matters related to risk management;

8) ensuring the availability of adequate resources and systems for risk management;

9) reviewing the organisational structure for risk management and providing recommendations regarding the same before approval by the Board;

10) verifying the independence of the risk management employees from activities that may expose the Company to risk;

11) ensuring that the risk management employees understand the risks threatening the Company and seeking to raise awareness of the culture of risk; and

12) reviewing any issues raised by the audit committee that may affect the Company's risk management.

Article 72: Meetings of the Risk Management Committee¹¹

The risk management committee shall convene periodically at least once every six months, and as may be necessary.

PART 5: Internal Control

Article 73: Internal Control System

The Board shall approve an internal control system for the Company in order to assess the policies and procedures relating to risk management, implementation of the provisions of the Company's governance rules approved by the Company and compliance with the relevant laws and regulations. Such system shall ensure compliance with clear accountability standards at all executive levels in the Company, and that Related Party transactions are implemented in accordance with the relevant provisions and controls.

Article 74: Establishing Independent Units or Departments within the Company

a) For purposes of implementing the approved internal control system, the Company shall establish units or departments for the assessment and management of risks and for internal auditing.

b) The Company may utilise external entities to perform the duties and competencies of the units or departments of risks assessments and management and internal control without prejudice to the Company's responsibility for those duties and competencies.

Article 75: Duties of the Internal Audit Unit or Department

An internal audit unit or department assesses and monitors the implementation of the internal control system, and verifies that the Company and its employees comply with the applicable laws, regulations and instructions, and the Company's policies and procedures.

Article 76: Composing An Internal Audit Unit or Department¹²

The internal audit unit or department shall be composed of at least one internal auditor whose appointment is recommended by the audit committee. Such internal auditor shall be responsible before the audit committee. The formation and operation of the internal audit unit or department shall take into consideration the following:

- 1) employees of such department shall be competent, independent and adequately trained, and shall not be entrusted with any other functions other than internal audit duties and internal control system;
- 2) the department shall report to the audit committee, and shall be subordinate and accountable to it;
- 3) the remunerations of the manager of the audit unit or department shall be determined by the a recommendation of the audit committee as per Company's policies; and
- 4) the department or unit shall be given access to information and documents, and shall be able to obtain the same without any restrictions.

Article 77: Internal Audit Plan¹³

The internal audit unit or department shall operate pursuant to a comprehensive audit plan approved by the audit committee. Such plan shall be updated annually. Key activities and operations, including the activities of risk management and compliance departments, shall be reviewed at least annually.

Article 78: Internal Audit Report¹⁴

- a) The internal audit unit or department shall prepare and submit a written report on its activities at least quarterly to the Board and the audit committee. Such report shall include an assessment of the Company's internal control system and the final

opinion and recommendations of the unit or department. Such report shall also specify the procedures taken by each department for addressing the findings and recommendations from the previous audit, and any remarks thereon, particularly failures to promptly address such findings and recommendations and the reasons for such failure;

b) The internal audit unit or department shall prepare a general written report to be submitted to the Board and the audit committee on the audit activities it carried during the fiscal year compared to the approved plan. Such report shall explain the reasons for any deviation from the plan, if any, during the quarter following the end of the relevant financial year;

c) The Board shall specify the scope of the report of the internal audit unit or department, based on recommendations from the audit committee and the internal audit unit or department. The report shall include the following in particular:

- 1) procedures for monitoring and overseeing the financial affairs, investments and risk management;
- 2) assessing the development of risk factors threatening the Company and the existing systems, in order to confront radical or unexpected changes in the Exchange;
- 3) an assessment of the performance of the Board and the Senior Management with respect to the implementation of internal control systems, including specifying the number of times the Board has been informed of control issues (including risk management) and a description of the method followed to address such issues;
- 4) failures or weaknesses in the implementation of internal control, or emergency situations that have affected or may affect the Company's financial performance, and the measures taken by the Company to address such failures (particularly the issues disclosed in the Company's annual reports and its financial statements);
- 5) the extent to which the Company has complied with the internal controls when determining and managing risks; and

- 6) information describing the Company's risk management operations

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Article 79: Maintaining Internal Audit Reports

The Company shall keep records of the audit reports and business documents, which shall clarify its accomplishments, findings and recommendations, and all actions taken in their regard.

PART 6: The Company's External Auditor

Article 80: Assigning the Audit Function

The Company shall assign the function of auditing its annual accounts to an independent and competent external auditor who possesses the necessary expertise and qualifications to prepare an objective and independent report to the Board and the shareholders, setting out whether the Company's financial statements clearly and impartially express the financial position of the Company and its performance in the significant areas.

Article 81: Appointment of the External Auditor

The Ordinary General Assembly shall appoint the Company's external auditor based on a recommendation from the Board, provided that the following requirements are met:

- 1) the nomination shall be based on a recommendation from the audit committee;
- 2) the external auditor shall be authorised by the Competent Authority;
- 3) the external auditor's interests shall not conflict with the interests of the Company; and 4) the number of nominees shall not be less than two.

Article 82: Duties of the External Auditor

The external auditor shall:

- 1) owe the duties of loyalty and care to the Company;
- 2) notify the Authority if the Board fails to take appropriate actions in respect of suspicious issues it raises; and
- 3) Request the Board to call for a General Assembly meeting if the Board has not facilitated his mission; and shall be liable to compensate the Company, the shareholders or third parties for the damages resulted from errors it commits in the course of its engagement. If an error is attributable to more than one external auditor, they shall be jointly responsible therefor.

PART 7: Stakeholders

Article 83: Regulating the Relationship with Stakeholders¹⁵

The Board shall establish clear and written policies and procedures regulating the relationship with Stakeholders with the aim of protecting them and safeguard their rights, which shall include the following, in particular:

- 1) methods to compensate Stakeholders when their rights established by laws or protected by contracts are infringed;
- 2) methods for resolving complaints or disputes that may arise between the Company and the Stakeholders;
- 3) methods for building good relationships with customers and suppliers and maintaining the confidentiality of their information;
- 4) rules of professional conduct for Company managers and employees that are prepared in compliance with the proper professional and ethical standards and regulate their relationship with Stakeholders, provided that the Board shall establish mechanisms for supervising the implementation of, and compliance with such rules;
- 5) the Company's social contributions;
- 6) ensuring that the Company's transactions with Board members and Related Parties are entered into on terms identical to the terms of transactions with Stakeholders without any discrimination or bias;
- 7) Stakeholders obtaining of information relevant to their activities to enable them to perform their duties. Such information shall be correct and sufficient and shall be provided in timely manner and on a regular basis; and
- 8) treating Company employees pursuant to the principles of justice and equality and without discrimination.

Article 84: Reporting Non-Compliant Practices

The Board shall, based upon a proposal from the audit committee, develop the necessary policies and procedures to be followed by Stakeholders when submitting complaints or reporting any violations, taking the following into consideration:

- 1) facilitating the method by which Stakeholders (including Company employees) report to the Board conducts and practices of the Executive Management's that violate applicable laws, regulations and rules or raising doubts as to the financial statements or the internal audit controls or others, whether such conducts or practices are against them or not, and conducting the necessary investigation in that regard;
- 2) maintaining the confidentiality of reporting procedures through facilitating direct contact with an independent member of the audit committee or other specialised committees;
- 3) appointing an employee to receive and address complaints or reports sent by Stakeholders;
- 4) dedicating a telephone number or an email address for receiving complaints; and
- 5) providing the necessary protection to the Stakeholders.

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Article 85: Employee Incentives¹⁶

The Company shall establish programmes for developing and encouraging the participation and performance of the Company's employees. The programmes shall particularly include the following:

- 1) forming committees or holding specialised workshops to hear the opinions of the Company's employees and discuss the issues and topics that are subject to important decisions;
- 2) establishing a scheme for granting Company shares or a percentage of the Company profits and pension programmes for employees, and setting up an independent fund for such programme; and
- 3) establishing social organisations for the benefit of the Company's employees.

PART 8: Professional and Ethical Standards

Article 86: Professional Conduct Policy

The Board shall establish a policy for professional conduct and ethical values at the Company, which shall particularly take the following into consideration:

- 1) ensuring that each member of the Board or the Executive Management and employees perform his/her duties of loyalty and care to the Company, and undertake the measures that may protect the Company's interests and contribute to its development and increase its value, and shall, at all times, prioritise the Company's interests over his/her own interests;
- 2) a Board member shall represent all shareholders of the Company and take all actions to achieve the best interests of the Company and its shareholders, while protecting the rights of the other Stakeholders rather than only the interests of the group that elected him;
- 3) entrench among the Board members and Senior Executives the principle of compliance with all relevant laws, regulations and instructions;
- 4) preventing the Board members or the Executive Management from abusing their positions with the aim of achieving benefits for himself/herself or a third party;
- 5) ensuring that the Company's assets and resources are only used to achieve the Company's purposes and objectives, and not to achieve personal interests; and
- 6) establishing accurate, well-formed, and clear rules regulating the authority to access the Company's internal information and timing to access it, in a way that prevents the Board members, the Executive Management and others from making personal use or disclosing the same to any person, except within the prescribed limits or as permitted by law.

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Article 87: Social Responsibility¹⁷

The Ordinary General Assembly, based on the Board recommendation, shall establish a policy that guarantees a balance between its objectives and those of the community for purposes of developing the social and economic conditions of the community.

Article 88: Social Initiatives¹⁸

The Board shall establish programmes and determine the necessary methods for proposing social initiatives by the Company, which include:

- 1) establishing indicators that link the Company's performance with its social initiatives and comparing it with other companies that engage in similar activities;
- 2) disclosing the objectives of the Company's social responsibility to its employees and raising their awareness and knowledge of social responsibility;
- 3) disclosing plans for achieving social responsibility in the periodical reports on the activities of the Company's; and
- 4) establishing awareness programmes to the community to familiarise them with the Company's social responsibility.

PART 9: Disclosure and Transparency

Article 89: Policies and Procedure of Disclosure

Without prejudice to the Listing Rules, the Board shall set forth in writing the policies, procedures and supervisory rules related to disclosure pursuant to the disclosure requirements provided for in the Companies Law and the Capital Market Law, as the case may be, and their implementing regulations, taking into consideration the following:

- 1) such policies shall include proper disclosure methods that enable the shareholders and other Stakeholders to access the financial and non-financial information pertaining to the Company's performance and information in respect of ownership of shares, and to obtain a comprehensive view of the Company's position;
- 2) disclosure to shareholders and investors shall be made without discrimination in a clear, correct and non-misleading fashion, and in a timely, regular and accurate

manner in order to enable shareholders and other Stakeholders to exercise their rights to the fullest extent;

3) the Company's website shall include all information required to be disclosed and any details or other information that may be published through other disclosure methods;19

4) reporting rules shall be established and shall describe the information required to be disclosed and the method of its classification in terms of its nature, and the frequency of its disclosure; and

5) the disclosure policies shall be reviewed periodically and their compliance with the best practices and the provisions of the Capital Market Law and its implementing rules shall be verified.

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Article 90: The Board's Report

The Board's report shall include the Board's operations during the last fiscal year and all factors that affect the company's businesses , such report shall include the following:

1) implemented and non-implemented provisions of these Regulations, and justifications therefor;

2) names, qualifications, and experience of the Board and committees members and Executive Management;

3) names of the companies inside and outside the Kingdom in which a Board member is a member of their current or previous Board member or manager;

4) composition of the Board and classification of its members, as follows: Executive Directors, Non-Executive Director, or Independent Director;

5) Procedure taken to the Board to inform its members , Non-Executive Directors in particular, of the shareholders' suggestions and remarks on the Company and its performance.

- 6) a brief description of the competencies and duties of the committees, such as the audit committee, the nomination committee and the remuneration committee indicating their names, names of their chairmen, names of their members, the number of their respective meetings, dates of those meetings and the members' attendance details of each meeting;
- 7) Where applicable, the means used by the Board to assess its performance, the performance of its committees and members and the external body which conducted the assessment and its relation with the Company, if any;
- 8) disclose the remuneration of the Board members and Executive Management as stated in Article (93) of these Regulations;
- 9) any punishment, penalty, precautionary procedure or preventive measure imposed on the Company by the Authority or any other supervisory, regulatory or judiciary authority, describing the reasons for non-compliance, the imposing authority and the measures undertaken to remedy and avoid such non-compliance in the future;
- 10) results of the annual review of the effectiveness of the internal control procedures of the Company and the opinion of the audit committee with respect to the adequacy of the Company's internal control system;
- 11) the audit committees recommendation on the need for appointing an internal auditor for the Company, if there is no internal auditor.
- 12) the audit committees recommendation with conflict with Board resolution or those which the Board disregards relating to the appointment, dismissal, assessment or determining the remuneration of an external auditor, as well as justifications for those recommendations and reasons for disregarding them.
- 13) details of the Company's social contributions, if any;
- 14) a list of the dates of the General Assembly meetings held during the last fiscal year and the names of the Board members who attended them.
- 15) a description of the main scope of business of the company and its affiliates. If there are two or more, a statement showing each activity and how it affects the company businesses and results shall be attached.

16) a description of the company's significant plans and decisions (including changes to the structure, expanding the company's operations or halting them) and the future expectations.

17) information on any risks facing the company (operational, financial or market related) and the policy of managing and monitoring these risks.

18) a summary in a form of table or graph showing the company's assets, liabilities and results of the last five fiscal year or since the incorporation date, whichever is shorter.

19) geographical analysis of the company's and its affiliates' revenues.

20) any material differences in the operational results compared to the preceding year's results, along with any expectations announced by the company.

21) any inconsistency with the standards approved by the Saudi Organisations for Certified Public Accountant.

22) name of each affiliate company, its capital, the company's ownership percentage, the main scope of business, country of operation and country of incorporation.

23) details of shares and debt instruments issued for each affiliate company.

24) a descriptions of the dividends distribution policy.

25) a description of any interest in a class of voting shares held by persons (other than the company's directors, Senior Executives and their relatives) who have notified the company of their holdings pursuant to Article 45 of Listing Rules, together with any change to such interests during the last fiscal year;

26) a description of any interest, contractual securities or rights issue of the Board members, Senior Executives and their relatives on shares or debt instruments of the company or its affiliates, and any change on these interest or rights during the last fiscal year.

27) information on any loans (payable upon request or not), a statement of the total indebtedness of the company and its affiliates, any amounts paid by the company in repayments of loans during the year, the amount of the principal debts, the creditor

name, the loan term and remaining amount. In case there is no debts, a declaration thereof shall be presented.

28) a description of the class and number of any convertible debt instruments, contractual securities, preemptive right or similar rights issued or granted by the company during the fiscal year, as well as stating any compensation obtained by the company in this regard.

29) a description of any conversion or subscription rights under any convertible debt instruments, contractually based securities, warrants or similar rights issued or granted by the company;.

30) description of any redemption, purchase or cancellation by the company of any redeemable debt instruments and the value of such securities outstanding, distinguishing between those listed securities purchased by the company and those purchased by its affiliates.

31) the number of Board meetings held during the last financial year, their dates and the attendance record of each meeting listing the names of the attendees.

32) numbers of company's requests of shareholders records, dates and reasons thereof.

33) a description of any transaction between the company and any Related Party.

34) information relating to any business or contract to which the company is a party and in which a director of the company, a Senior Executive or any person related to any of them is or was interested, including the names of persons in relation, the nature, conditions, durations and the amount of the business or contract. If there are no such businesses or contracts, the company must submit a statement thereof.

35) a description of any arrangement or agreement under which a director or a Senior Executive of the company has waived any remuneration.

36) a description of any arrangement or agreement under which a shareholder of the company has waived any rights to dividends.

37) a statement of the value of any paid and outstanding statutory payment on account of any zakat, taxes, fees or any other charges that have not been paid until

the end of the annual financial period with a brief description and the reasons therefor.

38) a statement as to the value of any investments made or any reserves set up for the benefit of the employees of the company.

39) declarations that:

- a. proper books of account have been maintained;
- b. the system of internal control is sound in design and has been effectively implemented;

and

- c. there are no significant doubts concerning the company's ability to continue its

activity.

40) if the external auditor's report contains reservations on the annual financial statements, the Board report shall highlight this mentioning the reasons and any relevant information.

41) if the Board recommended replacing the external auditor before the end of its term, the report shall indicate this mentioning the reasons for the replacement recommendation.

Article 91: The Audit Committee's Report

a) The report of the audit shall include details of its performance of its competencies and duties stated in the Companies Law and Its Implementing Regulations, provided that the report contains its recommendations and opinion on the adequacy of the internal and financial control systems and risk management systems in the Company.

b) The Board shall make available sufficient copies of the audit committees' report at the Company's head office, and publish them on the Company's and the Exchange's websites when publishing the invitation to convene the General Assembly, to enable shareholders to get a copy thereof. Summary of the report shall be read at the General Assembly.

Article 92: Disclosure by the Board

The Board shall regulate the disclosures of each of its members and the members of the Executive Management, observing the following:

- 1) maintaining a register for the disclosures of the Board members and the Executive Management and updating it regularly based on disclosures required as per the Companies Law, the Capital Market Law and their implementing regulations; and 2) making such register available for review by the Company's shareholders free of charge.

Article 93: Disclosure of Remunerations

a) The Board shall:

- 1) disclose the remuneration policy and the method by which remunerations of the Board and executive management are determined;
- 2) provide an accurate, transparent and detailed disclosure in the Board report on the remunerations granted to the Board members and Executive Management, directly or indirectly, without any omission or misleading information, and whether these were

in cash or other benefits of any nature. In case they were shares of the Company, the value of the shares is the market value on the due date;

- 3) explain the relationship between remunerations granted and applicable remuneration policy, highlighting any significant deviation from such policy; Board
- 4) a description of the necessary details with respect to the remunerations and compensations granted to each of the following, separately:
 - a. Board members;
 - b. five Senior Executives who have received the highest remuneration from the Company, provided that the chief executive officer and chief financial officer are among them.
 - c. members of committees.

b) The disclosures in this article and in the Board report shall be pursuant to the appended schedule.

Part 10: Implementation of Corporate Governance

Article 94: Implementation of Effective Governance

The Board shall establish governance rules for the Company in accordance with the provisions of these Regulations, and shall monitor their implementation, verify their effectiveness, and amend them as necessary. To that end, the Board shall:

- 1) verify that the Company is in compliance with these rules;
- 2) review and update the rules pursuant to statutory requirements and best practices;
- 3) review and develop codes of professional conduct representing the Company's values and other internal policies and procedures in order to fulfill the Company's requirements and in accordance with best practices; and
- 4) regularly inform the Board members of the developments in corporate governance and best practices, or authorise the audit committee or any other committee or department to undertake this task.

Article 95: Formation of a Corporate Governance Committee²⁰

If the Board forms a corporate governance committee, it shall assign to it the competences stipulated in Article (94) of these Regulations. Such committee shall oversee any matters relating to the implementation of governance, and shall provide the Board with its reports and recommendations at least annually.

Part 11: Retaining of Documents

Article 96: Retaining of Documents

A company shall retain all minutes, documents, reports and other papers required to be maintained in the company's head office for at least ten years as per these Regulations. This shall include the Board report and audit committee report. Without prejudice to this period, a company, in case of any lawsuit (filed or threatened to be filed) or ongoing claim or any investigation relating to those minutes, documents, reports and other papers, shall maintain them until the end of the ongoing lawsuit, claim or investigation.

Part 12: Closing Provisions

Article 97: Providing the Additional data and Information

The Authority may request from the Company any additional information or details it deems necessary to verify the extent of its compliance with the provisions of these Regulations.

Article 98: Publication and Entry into Force

These Regulations shall be effective as per its approval resolution.

Appendix (1) Remuneration Schedule

Board Remuneration

	Fixed remunerations						Variable remunerations						End-of-service award	Aggregate Amount	Expenses Allowance
	Specific amount	Allowance for attending Board meetings	Total Allowance for attending committee meetings	In-kind benefits	Remunerations for technical, managerial and consultative work	Remunerations of the chairman, Managing Director or Secretary, if a member	Total	Percentage of the profits	Periodic remunerations	Short-term incentive plans	Long-term incentive plans	Granted shares (insert the value)			
First: Independent Directors															
1-															
2-															
3-															
Total															
Second: Non- Executive Directors															
1-															
2-															
3-															
Total															
Third: Executive															

Directors																
1-																
2-																
3-																
Total																

Remunerations of Senior Executives

Senior Executives	Fixed remunerations				Variable remunerations					End-ofservice award	Total remunerations for Board executives, if any	Aggregate Amount
	Salaries	Allowances	In-kind benefits	Total	Periodic remunerations	Profits	Short-term incentive plans	Long-term incentive plans	Granted shares: insert the value)			
1- CEO												
2- CFO												
3-												
4-												
5-												
Total												

Committees Members Remuneration

	Fixed Remuneration (Except for the allowance for attending Board meetings)	Allowance for attending Board meetings	Total
Audit Committee Members			
1-			
2-			
3-			
Total			
Remuneration Committee Members			
1-			
2-			
3-			
Total			
Nomination Committee Members			
1-			
2-			
3-			
Total			
Risks Committee Members			
1-			
2-			

3-			
Total			
(.....) Committee Members			
1-			
2-			
3-			
Total			

Appendix B



Financial Reporting Council

April 2016

The UK Corporate Governance Code

The FRC is responsible for promoting high quality corporate governance and reporting to foster investment. We set the UK Corporate Governance and Stewardship Codes as well as UK standards for accounting, auditing and actuarial work. We represent UK interests in international standard-setting. We also monitor and take action to promote the quality of corporate reporting and auditing. We operate independent disciplinary arrangements for accountants and actuaries, and oversee the regulatory activities of the accountancy and actuarial professional bodies. The FRC does not accept any liability to any party for any loss, damage or costs howsoever arising, whether directly or indirectly, whether in contract, tort or otherwise from any action or decision taken (or not taken) as a result of any person relying on or otherwise using this document or arising from any omission from it.

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Governance and the Code

1. The purpose of corporate governance is to facilitate effective, entrepreneurial and prudent management that can deliver the long-term success of the company.
2. The first version of the UK Corporate Governance Code (the Code) was produced in 1992 by the Cadbury Committee. Its paragraph 2.5 is still the classic definition of the context of the Code:

Corporate governance is the system by which companies are directed and controlled. Boards of directors are responsible for the governance of their companies. The shareholders' role in governance is to appoint the directors and the auditors and to satisfy themselves that an appropriate governance structure is in place. The responsibilities of the board include setting the company's strategic aims, providing the leadership to put them into effect, supervising the management of the business and reporting to shareholders on their stewardship. The board's actions are subject to laws, regulations and the shareholders in general meeting.

3. Corporate governance is therefore about what the board of a company does and how it sets the values of the company. It is to be distinguished from the day to day operational management of the company by full-time executives.
4. The Code is a guide to a number of key components of effective board practice. It is based on the underlying principles of all good governance: accountability, transparency, probity and focus on the sustainable success of an entity over the longer term.
5. The Code has been enduring, but it is not immutable. Its fitness for purpose in a permanently changing economic and social business environment requires its evaluation at appropriate intervals.
6. The new Code applies to accounting periods beginning on or after 17 June 2016 and applies to all companies with a Premium listing of equity shares regardless of whether they are incorporated in the UK or elsewhere.

Preface

1. Over two decades of constructive usage of the Code have contributed to improved corporate governance in the UK. The Code is part of a framework of legislation, regulation and best practice standards which aims to deliver high quality corporate governance with in-built flexibility for companies to adapt their practices to take into account their particular circumstances. Similarly, investors must take the opportunity to consider carefully how companies have decided to implement the Code. There is always scope for improvement, both in terms of making sure that the Code remains relevant and improving the quality of reporting.
2. Boards must continue to think comprehensively about their overall tasks and the implications of these for the roles of their individual members. Absolutely key in these endeavours are the leadership of the chairman of a board, the support given to and by the CEO, and the frankness and openness of mind with which issues are discussed and tackled by all directors.
3. Essential to the effective functioning of any board is dialogue which is both constructive and challenging. The problems arising from “groupthink” have been exposed in particular as a result of the financial crisis. One of the ways in which constructive debate can be encouraged is through having sufficient diversity on the board. This includes, but is not limited to, gender and race. Diverse board composition in these respects is not on its own a guarantee. Diversity is as much about differences of approach and experience, and it is very important in ensuring effective engagement with key stakeholders and in order to deliver the business strategy.
4. One of the key roles for the board includes establishing the culture, values and ethics of the company. It is important that the board sets the correct ‘tone from the top’. The directors should lead by example and ensure that good standards of behaviour permeate throughout all levels of the organisation. This will help prevent misconduct, unethical practices and support the delivery of long-term success.
5. This update of the Code has been driven by the consequential changes required from the implementation of the European Union’s Audit Regulation and Directive. Section C.3 on Audit Committees was reviewed to ensure it remained consistent and changes have only been made when necessary. It is important that companies view these changes alongside the revised Guidance on Audit Committees.
6. Following the 2014 Code amendments, which focussed on the provision by companies of information about the risks which affect longer term viability, the FRC will continue to monitor compliance with these changes. Companies should be presenting information to give a clearer and broader view of solvency, liquidity, risk management and viability. For their part, investors should assess these statements thoroughly and engage accordingly.
7. To run a corporate board successfully should not be underrated. Constraints on time and knowledge combine with the need to maintain mutual respect and openness between a cast of strong, able and busy directors dealing with each other across the different demands of executive and non-executive roles. To achieve good governance requires continuing and high quality effort.
8. Chairmen are encouraged to report personally in their annual statements how the principles relating to the role and effectiveness of the board (in Sections A and B of the Code) have been applied. Not only will this give investors a clearer picture of the steps taken by boards to operate effectively but also, by providing fuller context, it may make investors more willing to accept explanations when a company chooses to explain rather than to comply with one or more provisions.

9. While in law the company is primarily accountable to its shareholders, and the relationship between the company and its shareholders is also the main focus of the Code, companies are encouraged to recognise the contribution made by other providers of capital and to confirm the board's interest in listening to the views of such providers insofar as these are relevant to the company's overall approach to governance.

Financial Reporting Council
April 2016

Comply or Explain

1. The “comply or explain” approach is the trademark of corporate governance in the UK. It has been in operation since the Code's beginnings and is the foundation of its flexibility. It is strongly supported by both companies and shareholders and has been widely admired and imitated internationally.
2. The Code is not a rigid set of rules. It consists of principles (main and supporting) and provisions. The Listing Rules require companies to apply the Main Principles and report to shareholders on how they have done so. The principles are the core of the Code and the way in which they are applied should be the central question for a board as it determines how it is to operate according to the Code.
3. It is recognised that an alternative to following a provision may be justified in particular circumstances if good governance can be achieved by other means. A condition of doing so is that the reasons for it should be explained clearly and carefully to shareholders,¹⁷ who may wish to discuss the position with the company and whose voting intentions may be influenced as a result. In providing an explanation, the company should aim to illustrate how its actual practices are consistent with the principle to which the particular provision relates, contribute to good governance and promote delivery of business objectives. It should set out the background, provide a clear rationale for the action it is taking, and describe any mitigating actions taken to address any additional risk and maintain conformity with the relevant principle. Where deviation from a particular provision is intended to be limited in time, the explanation should indicate when the company expects to conform with the provision.
4. In their responses to explanations, shareholders should pay due regard to companies' individual circumstances and bear in mind in particular the size and complexity of the company and the nature of the risks and challenges it faces. Whilst shareholders have every right to challenge companies' explanations if they are unconvincing, they should not be evaluated in a mechanistic way and departures from the Code should not be automatically treated as breaches. Shareholders should be careful to respond to the statements from companies in a manner that supports the “comply or explain” process and bearing in mind the purpose of good corporate governance. They should put their views to the company and both parties should be prepared to discuss the position.
5. Smaller listed companies, in particular those new to listing, may judge that some of the provisions are disproportionate or less relevant in their case. Some of the provisions do not apply to companies below the FTSE 350. Such companies may nonetheless consider that it would be appropriate to adopt the approach in the Code and they are encouraged to do so. Externally managed investment companies typically have a different board structure which may affect the relevance of particular provisions;

¹⁷ References to shareholders in this section also apply to intermediaries and agents employed to assist shareholders in scrutinising governance arrangements.

the Association of Investment Companies' Corporate Governance Code and Guide can assist them in meeting their obligations under the Code.

6. Satisfactory engagement between company boards and investors is crucial to the health of the UK's corporate governance regime. Companies and shareholders both have responsibility for ensuring that "comply or explain" remains an effective alternative to a rules-based system. There are practical and administrative obstacles to improved interaction between boards and shareholders. But certainly there is also scope for an increase in trust which could generate a virtuous upward spiral in attitudes to the Code and in its constructive use.

The Main Principles of the Code

Section A: Leadership

Every company should be headed by an effective board which is collectively responsible for the long-term success of the company.

There should be a clear division of responsibilities at the head of the company between the running of the board and the executive responsibility for the running of the company's business. No one individual should have unfettered powers of decision.

The chairman is responsible for leadership of the board and ensuring its effectiveness on all aspects of its role.

As part of their role as members of a unitary board, non-executive directors should constructively challenge and help develop proposals on strategy.

Section B: Effectiveness

The board and its committees should have the appropriate balance of skills, experience, independence and knowledge of the company to enable them to discharge their respective duties and responsibilities effectively.

There should be a formal, rigorous and transparent procedure for the appointment of new directors to the board.

All directors should be able to allocate sufficient time to the company to discharge their responsibilities effectively.

All directors should receive induction on joining the board and should regularly update and refresh their skills and knowledge.

The board should be supplied in a timely manner with information in a form and of a quality appropriate to enable it to discharge its duties.

The board should undertake a formal and rigorous annual evaluation of its own performance and that of its committees and individual directors.

All directors should be submitted for re-election at regular intervals, subject to continued satisfactory performance.

Section C: Accountability

The board should present a fair, balanced and understandable assessment of the company's position and prospects.

The board is responsible for determining the nature and extent of the principal risks it is willing to take in achieving its strategic objectives. The board should maintain sound risk management and internal control systems.

The board should establish formal and transparent arrangements for considering how they should apply the corporate reporting, risk management and internal control principles and for maintaining an appropriate relationship with the company's auditors.

Section D: Remuneration

Executive directors' remuneration should be designed to promote the long-term success of the company. Performance-related elements should be transparent, stretching and rigorously applied.

There should be a formal and transparent procedure for developing policy on executive remuneration and for fixing the remuneration packages of individual directors. No director should be involved in deciding his or her own remuneration.

Section E: Relations with shareholders

There should be a dialogue with shareholders based on the mutual understanding of objectives. The board as a whole has responsibility for ensuring that a satisfactory dialogue with shareholders takes place.

The board should use general meetings to communicate with investors and to encourage their participation.

Section A: Leadership

A.1: The Role of the Board

Main Principle

Every company should be headed by an effective board which is collectively responsible for the long-term success of the company.

Supporting Principles

The board's role is to provide entrepreneurial leadership of the company within a framework of prudent and effective controls which enables risk to be assessed and managed. The board should set the company's strategic aims, ensure that the necessary financial and human resources are in place for the company to meet its objectives and review management performance. The board should set the company's values and standards and ensure that its obligations to its shareholders and others are understood and met.

All directors must act in what they consider to be the best interests of the company, consistent with their statutory duties.¹⁸

¹⁸ For directors of UK incorporated companies, these duties are set out in the Sections 170 to 177 of the Companies Act 2006.

Code Provisions

- A.1.1. The board should meet sufficiently regularly to discharge its duties effectively. There should be a formal schedule of matters specifically reserved for its decision. The annual report should include a statement of how the board operates, including a high level statement of which types of decisions are to be taken by the board and which are to be delegated to management.
- A.1.2. The annual report should identify the chairman, the deputy chairman (where there is one), the chief executive, the senior independent director and the chairmen and members of the board committees.¹⁹ It should also set out the number of meetings of the board and those committees and individual attendance by directors.
- A.1.3. The company should arrange appropriate insurance cover in respect of legal action against its directors.

A.2: Division of Responsibilities

Main Principle

There should be a clear division of responsibilities at the head of the company between the running of the board and the executive responsibility for the running of the company's business. No one individual should have unfettered powers of decision.

Code Provision

- A.2.1 The roles of chairman and chief executive should not be exercised by the same individual. The division of responsibilities between the chairman and chief executive should be clearly established, set out in writing and agreed by the board.

A.3: The Chairman

Main Principle

The chairman is responsible for leadership of the board and ensuring its effectiveness on all aspects of its role.

Supporting Principles

The chairman is responsible for setting the board's agenda and ensuring that adequate time is available for discussion of all agenda items, in particular strategic issues. The chairman should also promote a culture of openness and debate by facilitating the effective contribution of non-executive directors in particular and ensuring constructive relations between executive and non-executive directors.

The chairman is responsible for ensuring that the directors receive accurate, timely and clear information. The chairman should ensure effective communication with shareholders.

Code Provision

- A.3.1. The chairman should on appointment meet the independence criteria set out in B.1.1 below. A chief executive should not go on to be chairman of the same company. If exceptionally a board decides that a chief executive should become chairman, the

¹⁹ Provisions A.1.1 and A.1.2 overlap with FCA Rule DTR 7.2.7 R; Provision A.1.2 also overlaps with DTR 7.1.5 R (see Schedule B).

board should consult major shareholders in advance and should set out its reasons to shareholders at the time of the appointment and in the next annual report.²⁰

A.4: Non-Executive Directors

Main Principle

As part of their role as members of a unitary board, non-executive directors should constructively challenge and help develop proposals on strategy.

Supporting Principle

Non-executive directors should scrutinise the performance of management in meeting agreed goals and objectives and monitor the reporting of performance. They should satisfy themselves on the integrity of financial information and that financial controls and systems of risk management are robust and defensible. They are responsible for determining appropriate levels of remuneration of executive directors and have a prime role in appointing and, where necessary, removing executive directors, and in succession planning.

Code Provisions

- A.4.1. The board should appoint one of the independent non-executive directors to be the senior independent director to provide a sounding board for the chairman and to serve as an intermediary for the other directors when necessary. The senior independent director should be available to shareholders if they have concerns which contact through the normal channels of chairman, chief executive or other executive directors has failed to resolve or for which such contact is inappropriate.
- A.4.2. The chairman should hold meetings with the non-executive directors without the executives present. Led by the senior independent director, the non-executive directors should meet without the chairman present at least annually to appraise the chairman's performance and on such other occasions as are deemed appropriate.
- A.4.3. Where directors have concerns which cannot be resolved about the running of the company or a proposed action, they should ensure that their concerns are recorded in the board minutes. On resignation, a non-executive director should provide a written statement to the chairman, for circulation to the board, if they have any such concerns.

²⁰ Compliance or otherwise with this provision need only be reported for the year in which the appointment is made.

Section B: Effectiveness

B.1: The Composition of the Board

Main Principle

The board and its committees should have the appropriate balance of skills, experience, independence and knowledge of the company to enable them to discharge their respective duties and responsibilities effectively.

Supporting Principles

The board should be of sufficient size that the requirements of the business can be met and that changes to the board's composition and that of its committees can be managed without undue disruption, and should not be so large as to be unwieldy.

The board should include an appropriate combination of executive and non-executive directors (and, in particular, independent non-executive directors) such that no individual or small group of individuals can dominate the board's decision taking.

The value of ensuring that committee membership is refreshed and that undue reliance is not placed on particular individuals should be taken into account in deciding chairmanship and membership of committees.

No one other than the committee chairman and members is entitled to be present at a meeting of the nomination, audit or remuneration committee, but others may attend at the invitation of the committee.

Code Provisions

B.1.1. The board should identify in the annual report each non-executive director it considers to be independent.²¹ The board should determine whether the director is independent in character and judgement and whether there are relationships or circumstances which are likely to affect, or could appear to affect, the director's judgement. The board should state its reasons if it determines that a director is independent notwithstanding the existence of relationships or circumstances which may appear relevant to its determination, including if the director:

- has been an employee of the company or group within the last five years;
- has, or has had within the last three years, a material business relationship with the company either directly, or as a partner, shareholder, director or senior employee of a body that has such a relationship with the company;
- has received or receives additional remuneration from the company apart from a director's fee, participates in the company's share option or a performance related pay scheme, or is a member of the company's pension scheme;
- has close family ties with any of the company's advisers, directors or senior employees;

²¹ A.3.1 states that the chairman should, on appointment, meet the independence criteria set out in this provision, but thereafter the test of independence is not appropriate in relation to the chairman.

- holds cross-directorships or has significant links with other directors through involvement in other companies or bodies;
- represents a significant shareholder; or
- has served on the board for more than nine years from the date of their first election.

B.1.2. Except for smaller companies,²² at least half the board, excluding the chairman, should comprise non-executive directors determined by the board to be independent. A smaller company should have at least two independent non-executive directors.

B.2: Appointments to the Board

Main Principle

There should be a formal, rigorous and transparent procedure for the appointment of new directors to the board.

Supporting Principles

The search for board candidates should be conducted, and appointments made, on merit, against objective criteria and with due regard for the benefits of diversity on the board, including gender.

The board should satisfy itself that plans are in place for orderly succession for appointments to the board and to senior management, so as to maintain an appropriate balance of skills and experience within the company and on the board and to ensure progressive refreshing of the board.

Code Provisions

B.2.1. There should be a nomination committee which should lead the process for board appointments and make recommendations to the board. A majority of members of the nomination committee should be independent non-executive directors. The chairman or an independent non-executive director should chair the committee, but the chairman should not chair the nomination committee when it is dealing with the appointment of a successor to the chairmanship. The nomination committee should make available its terms of reference, explaining its role and the authority delegated to it by the board.²³

B.2.2. The nomination committee should evaluate the balance of skills, experience, independence and knowledge on the board and, in the light of this evaluation, prepare a description of the role and capabilities required for a particular appointment.

B.2.3. Non-executive directors should be appointed for specified terms subject to re-election and to statutory provisions relating to the removal of a director. Any term beyond six years for a non-executive director should be subject to particularly rigorous review, and should take into account the need for progressive refreshing of the board.

²² A smaller company is one that is below the FTSE 350 throughout the year immediately prior to the reporting year.

²³ The requirement to make the information available would be met by including the information on a website that is maintained by or on behalf of the company.

B.2.4. A separate section of the annual report should describe the work of the nomination committee,²⁴ including the process it has used in relation to board appointments. This section should include a description of the board's policy on diversity, including gender, any measurable objectives that it has set for implementing the policy, and progress on achieving the objectives. An explanation should be given if neither an external search consultancy nor open advertising has been used in the appointment of a chairman or a non-executive director. Where an external search consultancy has been used, it should be identified in the annual report and a statement made as to whether it has any other connection with the company.

B.3: Commitment

Main Principle

All directors should be able to allocate sufficient time to the company to discharge their responsibilities effectively.

Code Provisions

B.3.1. For the appointment of a chairman, the nomination committee should prepare a job specification, including an assessment of the time commitment expected, recognising the need for availability in the event of crises. A chairman's other significant commitments should be disclosed to the board before appointment and included in the annual report. Changes to such commitments should be reported to the board as they arise, and their impact explained in the next annual report.

B.3.2. The terms and conditions of appointment of non-executive directors should be made available for inspection.²⁵ The letter of appointment should set out the expected time commitment. Non-executive directors should undertake that they will have sufficient time to meet what is expected of them. Their other significant commitments should be disclosed to the board before appointment, with a broad indication of the time involved and the board should be informed of subsequent changes.

B.3.3. The board should not agree to a full time executive director taking on more than one non-executive directorship in a FTSE 100 company nor the chairmanship of such a company.

B.4: Development

Main Principle

All directors should receive induction on joining the board and should regularly update and refresh their skills and knowledge.

Supporting Principles

The chairman should ensure that the directors continually update their skills and the knowledge and familiarity with the company required to fulfil their role both on the board and

²⁴ This provision overlaps with FCA Rule DTR 7.2.7 R (see Schedule B).

²⁵ The terms and conditions of appointment of non-executive directors should be made available for inspection by any person at the company's registered office during normal business hours and at the AGM (for 15 minutes prior to the meeting and during the meeting).

on board committees. The company should provide the necessary resources for developing and updating its directors' knowledge and capabilities.

To function effectively all directors need appropriate knowledge of the company and access to its operations and staff.

Code Provisions

B.4.1. The chairman should ensure that new directors receive a full, formal and tailored induction on joining the board. As part of this, directors should avail themselves of opportunities to meet major shareholders.

B.4.2. The chairman should regularly review and agree with each director their training and development needs.

B.5: Information and Support

Main Principle

The board should be supplied in a timely manner with information in a form and of a quality appropriate to enable it to discharge its duties.

Supporting Principles

The chairman is responsible for ensuring that the directors receive accurate, timely and clear information. Management has an obligation to provide such information but directors should seek clarification or amplification where necessary.

Under the direction of the chairman, the company secretary's responsibilities include ensuring good information flows within the board and its committees and between senior management and non-executive directors, as well as facilitating induction and assisting with professional development as required.

The company secretary should be responsible for advising the board through the chairman on all governance matters.

Code Provisions

B.5.1. The board should ensure that directors, especially non-executive directors, have access to independent professional advice at the company's expense where they judge it necessary to discharge their responsibilities as directors. Committees should be provided with sufficient resources to undertake their duties.

B.5.2. All directors should have access to the advice and services of the company secretary, who is responsible to the board for ensuring that board procedures are complied with. Both the appointment and removal of the company secretary should be a matter for the board as a whole.

B.6: Evaluation

Main Principle

The board should undertake a formal and rigorous annual evaluation of its own performance and that of its committees and individual directors.

Supporting Principles

Evaluation of the board should consider the balance of skills, experience, independence and knowledge of the company on the board, its diversity, including gender, how the board works together as a unit, and other factors relevant to its effectiveness.

The chairman should act on the results of the performance evaluation by recognising the strengths and addressing the weaknesses of the board and, where appropriate, proposing new members be appointed to the board or seeking the resignation of directors.

Individual evaluation should aim to show whether each director continues to contribute effectively and to demonstrate commitment to the role (including commitment of time for board and committee meetings and any other duties).

Code Provisions

- B.6.1. The board should state in the annual report how performance evaluation of the board, its committees and its individual directors has been conducted.
- B.6.2. Evaluation of the board of FTSE 350 companies should be externally facilitated at least every three years. The external facilitator should be identified in the annual report and a statement made as to whether they have any other connection with the company.
- B.6.3. The non-executive directors, led by the senior independent director, should be responsible for performance evaluation of the chairman, taking into account the views of executive directors.

B.7: Re-election

Main Principle

All directors should be submitted for re-election at regular intervals, subject to continued satisfactory performance.

Code Provisions

- B.7.1. All directors of FTSE 350 companies should be subject to annual election by shareholders. All other directors should be subject to election by shareholders at the first annual general meeting after their appointment, and to re-election thereafter at intervals of no more than three years. Non-executive directors who have served longer than nine years should be subject to annual re-election. The names of directors submitted for election or re-election should be accompanied by sufficient biographical details and any other relevant information to enable shareholders to take an informed decision on their election.

B.7.2. The board should set out to shareholders in the papers accompanying a resolution to elect a non-executive director why they believe an individual should be elected. The chairman should confirm to shareholders when proposing re-election that, following formal performance evaluation, the individual's performance continues to be effective and to demonstrate commitment to the role.

Section C: Accountability

C.1: Financial and Business Reporting

Main Principle

The board should present a fair, balanced and understandable assessment of the company's position and prospects. *Supporting Principles*

The board's responsibility to present a fair, balanced and understandable assessment extends to interim and other price-sensitive public reports and reports to regulators as well as to information required to be presented by statutory requirements.

The board should establish arrangements that will enable it to ensure that the information presented is fair, balanced and understandable.

Code Provisions

- C.1.1. The directors should explain in the annual report their responsibility for preparing the annual report and accounts, and state that they consider the annual report and accounts, taken as a whole, is fair, balanced and understandable and provides the information necessary for shareholders to assess the company's position and performance, business model and strategy. There should be a statement by the auditor about their reporting responsibilities.²⁶
- C.1.2. The directors should include in the annual report an explanation of the basis on which the company generates or preserves value over the longer term (the business model) and the strategy for delivering the objectives of the company.²⁷
- C.1.3. In annual and half-yearly financial statements, the directors should state whether they considered it appropriate to adopt the going concern basis of accounting in preparing them, and identify any material uncertainties to the company's ability to continue to do so over a period of at least twelve months from the date of approval of the financial statements.²⁸

²⁶ This requirement may be met by the disclosures about the audit scope and responsibilities of the auditor included, or referred to, in the auditor's report pursuant to the requirements of ISA (UK) 700 'Forming an Opinion and Reporting on Financial Statements' – Paragraphs 38-40. Copies are available from the FRC website.

²⁷ Section 414C(8) (a) and (b) of the Companies Act 2006 requires a description of a company's business model and strategy as part of the Strategic Report that forms part of the annual report. Guidance as to the matters that should be considered in an explanation of the business model and strategy is provided in the FRC's "Guidance on the Strategic Report". Copies are available from the FRC website.

²⁸ This provision overlaps with FCA Rules LR 9.8.6 R (3) (see Schedule B). Additional information relating to C.1.3 and C.2 can be found in "Guidance on Risk Management, Internal Control and Related Financial and Business Reporting". Copies are available from the FRC website.

C.2: Risk Management and Internal Control

Main Principle

The board is responsible for determining the nature and extent of the principal risks it is willing to take in achieving its strategic objectives. The board should maintain sound risk management and internal control systems.

Code Provisions

- C.2.1. The directors should confirm in the annual report that they have carried out a robust assessment of the principal risks facing the company, including those that would threaten its business model, future performance, solvency or liquidity. The directors should describe those risks and explain how they are being managed or mitigated.
- C.2.2. Taking account of the company's current position and principal risks, the directors should explain in the annual report how they have assessed the prospects of the company, over what period they have done so and why they consider that period to be appropriate. The directors should state whether they have a reasonable expectation that the company will be able to continue in operation and meet its liabilities as they fall due over the period of their assessment, drawing attention to any qualifications or assumptions as necessary.²⁹
- C.2.3. The board should monitor the company's risk management and internal control systems and, at least annually, carry out a review of their effectiveness, and report on that review in the annual report.³⁰ The monitoring and review should cover all material controls, including financial, operational and compliance controls.

C.3: Audit Committee and Auditors³¹

Main Principle

The board should establish formal and transparent arrangements for considering how they should apply the corporate reporting and risk management and internal control principles and for maintaining an appropriate relationship with the company's auditors.

Code Provisions

- C.3.1. The board should establish an audit committee of at least three, or in the case of smaller companies³² two, independent non-executive directors. In smaller companies the company chairman may be a member of, but not chair, the committee in addition to the independent non-executive directors, provided he or she was considered independent on appointment as chairman. The board should satisfy itself that at least one member of the audit committee has recent and relevant financial experience.

²⁹ This provision overlaps with FCA Rules LR 9.8.6 (3) R (see Schedule B).

³⁰ In addition FCA Rule DTR 7.2.5 R requires companies to describe the main features of the internal control and risk management systems in relation to the financial reporting process.

³¹ "Guidance on Audit Committees" suggests means of applying this part of the Code. Copies are available from the FRC website.

³² See footnote 6.

The audit committee as a whole shall have competence relevant to the sector in which the company operates.³³

C.3.2. The main role and responsibilities of the audit committee should be set out in written terms of reference³⁴ and should include:

- to monitor the integrity of the financial statements of the company and any formal announcements relating to the company's financial performance, reviewing significant financial reporting judgements contained in them;
- to review the company's internal financial controls and, unless expressly addressed by a separate board risk committee composed of independent directors, or by the board itself, to review the company's internal control and risk management systems;
- to monitor and review the effectiveness of the company's internal audit function;
- to make recommendations to the board, for it to put to the shareholders for their approval in general meeting, in relation to the appointment, re-appointment and removal of the external auditor and to approve the remuneration and terms of engagement of the external auditor;
- to review and monitor the external auditor's independence and objectivity and the effectiveness of the audit process, taking into consideration relevant UK professional and regulatory requirements;
- to develop and implement policy on the engagement of the external auditor to supply non-audit services, taking into account relevant ethical guidance regarding the provision of non-audit services by the external audit firm; and to report to the board, identifying any matters in respect of which it considers that action or improvement is needed and making recommendations as to the steps to be taken; and
- to report to the board on how it has discharged its responsibilities.

C.3.3. The terms of reference of the audit committee, including its role and the authority delegated to it by the board, should be made available.³⁵

C.3.4. Where requested by the board, the audit committee should provide advice on whether the annual report and accounts, taken as a whole, is fair, balanced and understandable and provides the information necessary for shareholders to assess the company's position and performance, business model and strategy.

C.3.5. The audit committee should review arrangements by which staff of the company may, in confidence, raise concerns about possible improprieties in matters of financial reporting or other matters. The audit committee's objective should be to ensure that arrangements are in place for the proportionate and independent investigation of such matters and for appropriate follow-up action.

³³ This provision overlaps with FCA Rule DTR 7.1.1A R (see Schedule B).

³⁴ This provision overlaps with FCA Rules DTR 7.1.3 R (see Schedule B).

³⁵ See footnote 7.

C.3.6. The audit committee should monitor and review the effectiveness of the internal audit activities. Where there is no internal audit function, the audit committee should consider annually whether there is a need for an internal audit function and make a recommendation to the board, and the reasons for the absence of such a function should be explained in the relevant section of the annual report.

C.3.7. The audit committee should have primary responsibility for making a recommendation on the appointment, reappointment and removal of the external auditors.³⁶ If the board does not accept the audit committee's recommendation, it should include in the annual report, and in any papers recommending appointment or re-appointment, a statement from the audit committee explaining the recommendation and should set out reasons why the board has taken a different position.

C.3.8. A separate section of the annual report should describe the work of the committee in discharging its responsibilities.³⁷ The report should include:

- the significant issues that the committee considered in relation to the financial statements, and how these issues were addressed;
- an explanation of how it has assessed the effectiveness of the external audit process and the approach taken to the appointment or reappointment of the external auditor, information on the length of tenure of the current audit firm, when a tender was last conducted and advance notice of any retendering plans;³⁸ and
- if the external auditor provides non-audit services, an explanation of how auditor objectivity and independence are safeguarded.

Section D: Remuneration

D.1: The Level and Components of Remuneration

Main Principle

Executive directors' remuneration should be designed to promote the long-term success of the company. Performance-related elements should be transparent, stretching and rigorously applied.

Supporting Principles

The remuneration committee should judge where to position their company relative to other companies. But they should use such comparisons with caution, in view of the risk of an upward ratchet of remuneration levels with no corresponding improvement in corporate and individual performance, and should avoid paying more than is necessary.

³⁶ This overlaps with Part 3 of The Statutory Audit Services for Large Companies Market Investigation (Mandatory Use of Competitive Tender Processes and Audit Committee Responsibilities) Order 2014 and the requirements of Chapter 2 of Part 16 of the Companies Act 2006 as inserted by the Statutory Auditors and Third Country Auditors Regulations 2016 on the appointment of auditors to public companies that are Public Interest Entities.

³⁷ This provision overlaps with FCA Rules DTR 7.1.5 R and 7.2.7 R (see Schedule B).

³⁸ This overlaps with Part 4 of The Statutory Audit Services for Large Companies Market Investigation (Mandatory Use of Competitive Tender Processes and Audit Committee Responsibilities) Order 2014.

They should also be sensitive to pay and employment conditions elsewhere in the group, especially when determining annual salary increases.

Code Provisions

- D.1.1. In designing schemes of performance-related remuneration for executive directors, the remuneration committee should follow the provisions in Schedule A to this Code. Schemes should include provisions that would enable the company to recover sums paid or withhold the payment of any sum, and specify the circumstances in which it would be appropriate to do so.
- D.1.2. Where a company releases an executive director to serve as a non-executive director elsewhere, the remuneration report³⁹ should include a statement as to whether or not the director will retain such earnings and, if so, what the remuneration is.
- D.1.3. Levels of remuneration for non-executive directors should reflect the time commitment and responsibilities of the role. Remuneration for non-executive directors should not include share options or other performance-related elements. If, exceptionally, options are granted, shareholder approval should be sought in advance and any shares acquired by exercise of the options should be held until at least one year after the non-executive director leaves the board. Holding of share options could be relevant to the determination of a non-executive director's independence (as set out in provision B.1.1).
- D.1.4. The remuneration committee should carefully consider what compensation commitments (including pension contributions and all other elements) their directors' terms of appointment would entail in the event of early termination. The aim should be to avoid rewarding poor performance. They should take a robust line on reducing compensation to reflect departing directors' obligations to mitigate loss.
- D.1.5. Notice or contract periods should be set at one year or less. If it is necessary to offer longer notice or contract periods to new directors recruited from outside, such periods should reduce to one year or less after the initial period.

D.2: Procedure

Main Principle

There should be a formal and transparent procedure for developing policy on executive remuneration and for fixing the remuneration packages of individual directors. No director should be involved in deciding his or her own remuneration.

Supporting Principles

The remuneration committee should take care to recognise and manage conflicts of interest when receiving views from executive directors or senior management, or consulting the chief executive about its proposals. The remuneration committee should also be responsible for appointing any consultants in respect of executive director remuneration.

³⁹ As required for UK incorporated companies under the Large and Medium-Sized Companies and Groups (Accounts and Reports) Regulations 2013.

The chairman of the board should ensure that the committee chairman maintains contact as required with its principal shareholders about remuneration.

Code Provisions

- D.2.1. The board should establish a remuneration committee of at least three, or in the case of smaller companies⁴⁰ two, independent non-executive directors. In addition the company chairman may also be a member of, but not chair, the committee if he or she was considered independent on appointment as chairman. The remuneration committee should make available its terms of reference, explaining its role and the authority delegated to it by the board.⁴¹ Where remuneration consultants are appointed, they should be identified in the annual report and a statement made as to whether they have any other connection with the company.
- D.2.2. The remuneration committee should have delegated responsibility for setting remuneration for all executive directors and the chairman, including pension rights and any compensation payments. The committee should also recommend and monitor the level and structure of remuneration for senior management. The definition of 'senior management' for this purpose should be determined by the board but should normally include the first layer of management below board level.
- D.2.3. The board itself or, where required by the Articles of Association, the shareholders should determine the remuneration of the non-executive directors within the limits set in the Articles of Association. Where permitted by the Articles, the board may however delegate this responsibility to a committee, which might include the chief executive.
- D.2.4. Shareholders should be invited specifically to approve all new long-term incentive schemes (as defined in the Listing Rules⁴²) and significant changes to existing schemes, save in the circumstances permitted by the Listing Rules.

Section E: Relations with shareholders

E.1: Dialogue with Shareholders

Main Principle

There should be a dialogue with shareholders based on the mutual understanding of objectives. The board as a whole has responsibility for ensuring that a satisfactory dialogue with shareholders takes place.⁴³

Supporting Principles

Whilst recognising that most shareholder contact is with the chief executive and finance director, the chairman should ensure that all directors are made aware of their major shareholders' issues and concerns.

⁴⁰ See footnote 6.

⁴¹ This provision overlaps with FCA Rule DTR 7.2.7 R (see Schedule B).

⁴² Listing Rules LR 9.4. Copies are available from the FCA website.

⁴³ Nothing in these principles or provisions should be taken to override the general requirements of law to treat shareholders equally in access to information.

The board should keep in touch with shareholder opinion in whatever ways are most practical and efficient.

Code Provisions

E.1.1. The chairman should ensure that the views of shareholders are communicated to the board as a whole. The chairman should discuss governance and strategy with major shareholders. Non-executive directors should be offered the opportunity to attend scheduled meetings with major shareholders and should expect to attend meetings if requested by major shareholders. The senior independent director should attend sufficient meetings with a range of major shareholders to listen to their views in order to help develop a balanced understanding of the issues and concerns of major shareholders.

E.1.2. The board should state in the annual report the steps they have taken to ensure that the members of the board, and in particular the non-executive directors, develop an understanding of the views of major shareholders about the company, for example through direct face-to-face contact, analysts' or brokers' briefings and surveys of shareholder opinion.

E.2: Constructive Use of General Meetings

Main Principle

The board should use general meetings to communicate with investors and to encourage their participation.

Code Provisions

E.2.1. At any general meeting, the company should propose a separate resolution on each substantially separate issue, and should in particular propose a resolution at the AGM relating to the report and accounts. For each resolution, proxy appointment forms should provide shareholders with the option to direct their proxy to vote either for or against the resolution or to withhold their vote. The proxy form and any announcement of the results of a vote should make it clear that a 'vote withheld' is

not a vote in law and will not be counted in the calculation of the proportion of the votes for and against the resolution.

E.2.2. The company should ensure that all valid proxy appointments received for general meetings are properly recorded and counted. For each resolution, where a vote has been taken on a show of hands, the company should ensure that the following information is given at the meeting and made available as soon as reasonably practicable on a website which is maintained by or on behalf of the company:

- the number of shares in respect of which proxy appointments have been validly made;
- the number of votes for the resolution;
- the number of votes against the resolution; and
- the number of shares in respect of which the vote was directed to be withheld.

When, in the opinion of the board, a significant proportion of votes have been cast against a resolution at any general meeting, the company should explain when announcing the results of voting what actions it intends to take to understand the reasons behind the vote result.

E.2.3. The chairman should arrange for the chairmen of the audit, remuneration and nomination committees to be available to answer questions at the AGM and for all directors to attend.

E.2.4. The company should arrange for the Notice of the AGM and related papers to be sent to shareholders at least 20 working days before the meeting. For other general meetings this should be at least 14 working days in advance.

Schedule A: The design of performance-related remuneration for executive directors

Balance

The remuneration committee should determine an appropriate balance between fixed and performance-related, immediate and deferred remuneration. Performance conditions, including non-financial metrics where appropriate, should be relevant, stretching and designed to promote the long-term success of the company. Remuneration incentives should be compatible with risk policies and systems. Upper limits should be set and disclosed.

The remuneration committee should consider whether the directors should be eligible for annual bonuses and/or benefits under long-term incentive schemes.

Share-based remuneration

Traditional share option schemes should be weighed against other kinds of long-term incentive scheme. Executive share options should not be offered at a discount save as permitted by the relevant provisions of the Listing Rules.

Any new long-term incentive schemes which are proposed should be approved by shareholders and should preferably replace any existing schemes or, at least, form part of a well-considered overall plan incorporating existing schemes. The total rewards potentially available should not be excessive.

For share-based remuneration the remuneration committee should consider requiring directors to hold a minimum number of shares and to hold shares for a further period after vesting or exercise, including for a period after leaving the company, subject to the need to finance any costs of acquisition and associated tax liabilities. In normal circumstances, shares granted or other forms of deferred remuneration should not vest or be paid, and options should not be exercisable, in less than three years. Longer periods may be appropriate. Grants under executive share option and other long-term incentive schemes should normally be phased rather than awarded in one large block.

Pensions

In general, only basic salary should be pensionable. The remuneration committee should consider the pension consequences and associated costs to the company of basic salary increases and any other changes in pensionable remuneration, especially for directors close to retirement.

Schedule B: Disclosure of corporate governance arrangements

Corporate governance disclosure requirements are set out in three places:

- FCA Disclosure and Transparency Rules (“DTR”) sub-chapters 7.1 and 7.2, which set out certain mandatory disclosures;
- FCA Listing Rules (“LR”) 9.8.6 R, 9.8.7 R, and 9.8.7A R, which includes the “comply or explain” requirement; and
- The UK Corporate Governance Code (“the Code”) – in addition to providing an explanation where they choose not to comply with a provision, companies must disclose specified information in order to comply with certain provisions.

These requirements are summarised below, with the full text contained in the relevant chapters of the FCA Handbook.

The DTR sub-chapters 7.1 and 7.2 apply to issuers whose securities are admitted to trading on a regulated market (this includes all issuers with a Premium or Standard listing). The LR 9.8.6 R, 9.8.7 R and 9.8.7A R and the Code apply to issuers of Premium listed equity shares only.

There is some overlap between the mandatory disclosures required under the DTR and those expected under the Code. Areas of overlap are summarised in the Appendix to this Schedule. In respect of disclosures relating to the audit committee and the composition and operation of the board and its committees, compliance with the relevant provisions of the Code will result in compliance with the relevant Rules.

Disclosure and Transparency Rules

DTR sub-chapter 7.1 concerns audit committees or bodies carrying out equivalent functions.

DTR 7.1.1 R, 7.1.1A R and 7.1.3 R set out requirements relating to the composition and functions of the committee or equivalent body:

- DTR 7.1.1 R states that an issuer must have a body or bodies responsible for performing the functions set out in DTR 7.1.3 R.
- DTR 7.1.1A R requires that a majority of the members of the relevant body must be independent, at least one member must have competence in accounting or auditing, or both, and that members of the relevant body as a whole must have competence relevant to the sector in which the issuer is operating.
- DTR 7.1.2 G states that the requirements for independence and competence in accounting and/or auditing may be satisfied by the same members or by different members of the relevant body.
- DTR 7.1.3 R states that an issuer must ensure that, as a minimum, the relevant body must:
 1. monitor the financial reporting process and submit recommendations or proposal to ensure its integrity;

2. monitor the effectiveness of the issuer's internal quality control and risk management systems and, where applicable, its internal audit, regarding the financial reporting of the issuer, without breaching its independence;
3. monitor the statutory audit of the annual and consolidated financial statements, in particular, its performance, taking into account any findings and conclusions by the competent authority under article 26(6) of the Audit Regulation;
4. review and monitor the independence of the statutory auditor, in accordance with articles 22, 22a, 22b, 24a and 24b of the Audit Directive and article 6 of the Audit Regulation, and in particular the appropriateness of the provision of non-audit services to the issuer in accordance with article 5 of the Audit Regulation;
5. inform the administrative or supervisory body of the issuer of the outcome of the statutory audit and explain how the statutory audit contributed to the integrity of financial reporting and what the role of the relevant body was in that process;
6. except when article 16(8) of the Audit Regulation is applied, be responsible for the procedure for the selection of statutory auditor(s) and recommend the statutory auditor(s) to be appointed in accordance with article 16 of the Audit Regulation.

DTR 7.1.5 R sets out what disclosure is required. Specifically:

- DTR 7.1.5 R states that the issuer must make a statement available to the public disclosing which body carries out the functions required by DTR 7.1.3 R and how it is composed.
- DTR 7.1.6 G states that this can be included in the corporate governance statement required under sub-chapter DTR 7.2 (see below).
- DTR 7.1.7 G states that compliance with the relevant provisions of the Code (as set out in the Appendix to this Schedule) will result in compliance with DTR 7.1.1 R to 7.1.5 R.

Sub-chapter 7.2 concerns corporate governance statements. Issuers are required to produce a corporate governance statement that must be either included in the directors' report (DTR 7.2.1 R); or set out in a separate report published together with the annual report; or set out in a document on the issuer's website, in which case there must be a cross-reference in the directors' report (DTR 7.2.9 R).

DTR 7.2.2 R requires that the corporate governance statement must contain a reference to the corporate governance code to which the company is subject (for companies with a Premium listing this is the Code). DTR 7.2.3 R requires that, where that it departs from that code, the company must explain which parts of the code it departs from and the reasons for doing so. DTR 7.2.4 G states that compliance with LR 9.8.6 R (6) (the "comply or explain" rule in relation to the Code) will also satisfy these requirements.

DTR 7.2.5 R, DTR 7.2.6 R, DTR 7.2.7 R and DTR 7.2.10 R set out certain information that must be disclosed in the corporate governance statement:

- DTR 7.2.5 R states that the corporate governance statement must contain a description of the main features of the company's internal control and risk management systems in relation to the financial reporting process. DTR 7.2.10 R states that an issuer which is required to prepare a group directors' report within the meaning of Section 415(2) of the Companies Act 2006 must include in that report a description of the main features of the group's internal control and risk management systems in relation to the financial reporting process for the undertakings included in the consolidation, taken as a whole.
- DTR 7.2.6 R states that the corporate governance statement must contain the information required by paragraph 13(2)(c), (d), (f), (h) and (i) of Schedule 7 to the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 (SI 2008/410) where the issuer is subject to the requirements of that paragraph.
- DTR 7.2.7 R states that the corporate governance statement must contain a description of the composition and operation of the issuer's administrative, management and supervisory bodies and their committees. DTR 7.2.8 G states that compliance with the relevant provisions of the Code (as set out in the Appendix to this Schedule) will satisfy these requirements.

Listing Rules

LR 9.8.6 R (for UK incorporated companies) and LR 9.8.7 R (for overseas incorporated companies) state that in the case of a company that has a Premium listing of equity shares, the following items must be included in its annual report and accounts:

- a statement of how the listed company has applied the Main Principles set out in the Code, in a manner that would enable shareholders to evaluate how the principles have been applied;
- a statement as to whether the listed company has:
 - complied throughout the accounting period with all relevant provisions set out in the Code; or
 - not complied throughout the accounting period with all relevant provisions set out in the Code, and if so, setting out:
 - (i) those provisions, if any, it has not complied with;
 - (ii) in the case of provisions whose requirements are of a continuing nature, the period within which, if any, it did not comply with some or all of those provisions; and
 - (iii) the company's reasons for non-compliance.

LR 9.8.6 R (3) requires statements by the *directors* on:

- (a) the appropriateness of adopting the going concern basis of accounting (containing the information set out in provision C.1.3 of the Code); and
- (b) their assessment of the prospects of the *company* (containing the information set out in provision C.2.2 of the Code);

prepared in accordance with the 'Guidance on Risk Management, Internal Control and Related Financial and Business Reporting' published by the Financial Reporting Council in September 2014;

The UK Corporate Governance Code

In addition to the "comply or explain" requirement in the LR, the Code includes specific requirements for disclosure which must be provided in order to comply. These are summarised below.

The annual report should include:

- a statement of how the board operates, including a high level statement of which types of decisions are to be taken by the board and which are to be delegated to management (A.1.1);
- the names of the chairman, the deputy chairman (where there is one), the chief executive, the senior independent director and the chairmen and members of the board committees (A.1.2);
- the number of meetings of the board and those committees and individual attendance by directors (A.1.2);
- where a chief executive is appointed chairman, the reasons for their appointment
(this only needs to be done in the annual report following the appointment) (A.3.1);
- the names of the non-executive directors whom the board determines to be independent, with reasons where necessary (B.1.1);
- a separate section describing the work of the nomination committee, including the process it has used in relation to board appointments; a description of the board's policy on diversity, including gender; any measurable objectives that it has set for implementing the policy, and progress on achieving the objectives. An explanation should be given if neither external search consultancy nor open advertising has been used in the appointment of a chairman or a non-executive director. Where an external search consultancy has been used it should be identified and a statement made as to whether it has any other connection with the company (B.2.4);
- the impact of any changes to the other significant commitments of the chairman during the year should explained (B.3.1);
- a statement of how performance evaluation of the board, its committees and its directors has been conducted (B.6.1). Where an external facilitator has been used, they should be identified and a statement made as to whether they have any other connection to the company (B.6.2);
- an explanation from the directors of their responsibility for preparing the accounts and a statement that they consider that the annual report and accounts, taken as a whole, is fair, balanced and understandable and provides the information necessary for shareholders to assess the company's position and performance, business model and strategy. There should also be a statement by the auditor about their reporting responsibilities (C.1.1);

- an explanation from the directors of the basis on which the company generates or preserves value over the longer term (the business model) and the strategy for delivering the objectives of the company (C.1.2);
- a statement from the directors whether they considered it appropriate to adopt the going concern basis of accounting in preparing them, and identify any material uncertainties to the company's ability to continue to do so over a period of at least twelve months from the date of approval of the financial statements (C.1.3);
- confirmation by the directors that they have carried out a robust assessment of the principal risks facing the company, including those that would threaten its business model, future performance, solvency or liquidity. The directors should describe the risks and explain how they are being managed or mitigated (C.2.1);
- a statement from the directors explaining how they have assessed the prospects of the company (taking account of the company's current position and principal risks), over what period they have done so and why they consider that period to be appropriate. The directors should state whether they have a reasonable expectation that the company will be able to continue in operation and meet its liabilities as they fall due over the period of their assessment, drawing attention to any qualifications or assumptions as necessary (C.2.2);
- a report on the board's review of the effectiveness of the company's risk management and internal controls systems (C.2.3);
- where there is no internal audit function, the reasons for the absence of such a function (C.3.6);
- where the board does not accept the audit committee's recommendation on the appointment, reappointment or removal of an external auditor, a statement from the audit committee explaining the recommendation and the reasons why the board has taken a different position (C.3.7);
- a separate section describing the work of the audit committee in discharging its responsibilities, including: the significant issues that it considered in relation to the financial statements, and how these issues were addressed; an explanation of how it has assessed the effectiveness of the external audit process and the approach taken to the appointment or reappointment of the external auditor, including the length of tenure of the current audit firm, when a tender was last conducted and advance notice of any retendering plans; and, if the external auditor provides non-audit services, an explanation of how auditor objectivity and independence is safeguarded (C.3.8);
- a description of the work of the remuneration committee as required under the Large and Medium-Sized Companies and Groups (Accounts and Reports) Regulations 2013, including, where an executive director serves as a nonexecutive director elsewhere, whether or not the director will retain such earnings and, if so, what the remuneration is (D.1.2);
- where remuneration consultants are appointed they should be identified and a statement made as to whether they have any other connection with the company (D.2.1); and

- the steps the board has taken to ensure that members of the board, and in particular the non-executive directors, develop an understanding of the views of major shareholders about their company (E.1.2).

The following information should be made available (which may be met by placing the information on a website that is maintained by or on behalf of the company):

- the terms of reference of the nomination, audit and remuneration committees, explaining their role and the authority delegated to them by the board (B.2.1, C.3.3 and D.2.1); and
- the terms and conditions of appointment of non-executive directors (B.3.2) (see footnote 9).

The board should set out to shareholders in the papers accompanying a resolution to elect or re-elect directors:

- sufficient biographical details to enable shareholders to take an informed decision on their election or re-election (B.7.1);
- why they believe an individual should be elected to a non-executive role (B.7.2); and
- on re-election of a non-executive director, confirmation from the chairman that, following formal performance evaluation, the individual's performance continues to be effective and to demonstrate commitment to the role (B.7.2).

The board should set out to shareholders in the papers recommending appointment or reappointment of an external auditor:

- if the board does not accept the audit committee's recommendation, a statement from the audit committee explaining the recommendation and from the board setting out reasons why they have taken a different position (C.3.7).

Additional guidance

The FRC publishes guidance on the strategic report, risk management, internal control, business and financial reporting and audit committees, which relate to Section C of the Code. These guidance notes are available on the FRC website.

Appendix

Overlap between the Disclosure and Transparency Rules and the UK Corporate Governance Code

Disclosure and Transparency Rules	UK Corporate Governance Code
<p>DTR 7.1.1 R and 7.1.1A R</p> <p>Sets out minimum requirements on composition of the audit committee or equivalent body.</p>	<p>Provision C.3.1: sets out the recommended composition of the audit committee.</p>
<p>DTR 7.1.3 R</p> <p>Sets out minimum functions of the audit committee or equivalent body.</p>	<p>Provision C.3.2: sets out the recommended minimum terms of reference for the audit committee.</p>
<p>DTR 7.1.5 R</p> <p>The composition and function of the audit committee or equivalent body/ bodies must be disclosed in the annual report.</p> <p><i>DTR 7.1.7 G states that compliance with Code provisions A.1.2, C.3.1, C.3.2, C.3.3. and C.3.8 will result in compliance with DTR 7.1.1 R to DTR 7.1.5 R.</i></p>	<p>This requirement overlaps with a number of different Code provisions:</p> <p>A.1.2: the annual report should identify members of the board and board committees.</p> <p>C.3.1: sets out the recommended composition of the audit committee.</p> <p>C.3.2: sets out the recommended minimum terms of reference for the audit committee.</p> <p>C.3.3: the terms of reference of the audit committee, including its role and the authority delegated to it by the board, should be made available.</p> <p>C.3.8: the annual report should describe the work of the audit committee.</p>
<p>DTR 7.2.5 R</p> <p>The corporate governance statement must contain a description of the main features of the issuer's internal control and risk management systems in relation to the financial reporting process.</p> <p><i>While this requirement differs from the requirement in the Code, it is envisaged that both could be met by a single internal control statement.</i></p>	<p>Provision C.2.1: the directors should confirm that they have carried out a robust assessment of the principal risks facing the company – including those that would threaten its business model, future performance, solvency or liquidity. The directors should describe those risks and explain how they are being managed or mitigated.</p> <p>Provision C.2.3: the board should monitor the company's risk management and internal control systems and, at least annually, carry out a review of their effectiveness, and report on that review in the annual report. The monitoring and review should cover all material controls, including financial, operational and compliance controls.</p>

Disclosure and Transparency Rules	UK Corporate Governance Code
<p>DTR 7.2.7 R</p> <p>The corporate governance statement must contain a description of the composition and operation of the issuer’s administrative, management and supervisory bodies and their committees.</p> <p><i>DTR 7.2.8 R states that compliance with Code provisions A.1.1, A.1.2, B.2.4, C.3.3, C.3.8 and D.2.1 will result in compliance with DTR 7.2.7 R.</i></p>	<p>This requirement overlaps with a number of different Code provisions:</p> <p>A.1.1: the annual report should include a statement of how the board operates.</p> <p>A. 1.2: the annual report should identify members of the board and board committees.</p> <p>B. 2.4: the annual report should describe the work of the nomination committee.</p> <p>C. 3.3: the terms of reference of the audit committee, including its role and the authority delegated to it by the board, should be made available.</p> <p>C. 3.8: the annual report should describe the work of the audit committee.</p> <p>D. 2.1: a description of the work of the remuneration committee should be made available. [<i>Note: in order to comply with DTR 7.2.7 R this information will need to be included in the corporate governance statement</i>]</p>

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Appendix C- List of UK Companies

No.	Sector	Name
1	Mining	Centamin
2		BHP Billiton
3		Antofagasta
4	Electricity	SSE PLC
5		DRAX
6	Food	Tate and Lyle
7		Dairy Crest Group
8		Cranswick
9		Carr's Group
10		ABF
11	Energy	Tullow
12		Cairn Energy
13		SOCO Intr.
14		BP PLC
15		Premier Oil
16	Industry Transportation	BBA Aviation
17		Wincanton
18		Clarkson
19		Fisher(James)
20		Breamar Shipping
21	Financial Services	Ashmore
22		Aberdeen Ass. Man.
23		Brewin Dolphin
24	Bank	Barclays
25		HSBC
26		Standard Chart.

Appendix D - List of KSA Companies

No.	Sector	Name
1	Petrochemical Industries	Advanced Petrochemical Co.
2		Alujain Corp.
3		Methanol Chemicals Co.
4		Nama Chemicals Co.
5		National Industrialization Co.
6		National Petrochemical Co.
7		Rabigh Refining and Petrochemical Co.
8		Sahara Petrochemical Co.
9		Saudi Arabia Fertilizers Co.
10		Saudi Basic Industries Corp.
11		Saudi Industrial Investment Group
12		Saudi International Petrochemical Co.
13	Cement	Al Jouf Cement Co.
14		Arabian Cement Co.
15		City Cement Co.
16		Eastern Province Cement Co.
17		Hail Cement Co.
18	Transport	National Shipping Company of Saudi Arabia
19		Saudi Public Transport Co.
20		Saudi Transport and Investment Co.
21		United International Transportation Co.
22	Energy and Utilities	National Gas and Industrialization Co.
23		Saudi Electricity Co.
24	Agriculture and Food Industries	Almarai Co.
25		Savola Group
26	Banks and Financial Services	Arab National
27		Albilad
28		Banque Saudi Fransi
29		Saudi British Bank
30		Samba Financial Group