VICTORIA UNIVERSITY

FACULTY OF BUSINESS & LAW

School of Accounting & Finance

CORPORATE GOVERNANCE IN SAUDI ARABIA: OVERVIEW AND EMPIRICAL INVESTIGATION

A Thesis Submitted for the Degree of

DOCTOR OF PHILOSOPHY

At
Victoria University

By

KHALID HAMAD AL-TURKI

BSc. In Accounting, King Saud University (Saudi Arabia)
MAcc (Master of Accountancy), Gonzaga University (U.S.A.)

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DECLARATION

This work has not previously been accepted in substance for any degree and is not being concurrently submitted in candidature for any degree. This thesis is the result of my own investigations, except where otherwise stated. Other sources are acknowledged giving explicit references. A bibliography is appended.

Signed [redacted] (Khalid Al-turki – Candidate)

Date 15-11-06

DEDICATION

This Thesis Is Dedicated With All My Love And Respect To My Parents, My Brother, My Sisters, My Wife And My Beloved Children, Tala, Hamad and Alwaleed

ACKNOWLEDGEMENT

I am grateful to Allah almighty for his guidance and blessings of my efforts during the course of this study.

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Most importantly, I would like to emphasise the heartfelt debt I owe to my mother and father for their love, prayer, encouragement and support, and to all my family members in Saudi Arabia for their encouragement and moral support.

Very lovely thanks are due to my beloved family here with me in Australia, to my lovely wife for her care, patience and understanding. She sacrificed a great deal and worked so hard to provide the right environment for the success of my research. My love also goes to my children, Tala, Hamad and Alwaleed, who gave me enormous joy and pleasure by just being here.

ABSTRACT

The primary objectives of this thesis are: (i) to review the ongoing practices of corporate governance in six developed and emerging markets that represent a broad and diverse sample that varies in terms of historical, legal, economic and cultural systems; (ii) to assess comprehensively the effectiveness of corporate governance in a unique developing country, Saudi Arabia; and (iii) to identify whether there are significant differences in the perceptions among the involved four samples (board of directors' members, chief executive officers 'CEOs', audit committee members and shareholders) towards the four mechanisms of corporate governance investigated in this study, namely: shareholders' rights; board of directors; audit committees and internal audit; and disclosure and transparency.

A mail-out questionnaire methodology was used. The populations in this study have been divided into two categories: (i) the entire board of directors' members, chief executive officers and audit committee members of the 71 listed Saudi joint stock companies; and (ii) 400 randomly selected shareholders.

Saudi joint stock corporations generally were found to be doing relatively well in allowing shareholders to exercise some shareholders' rights such as secure registration, sharing in profits and participating in general meetings. Minority shareholders, however, seem to encounter difficulties in understanding their rights, calling special shareholders' meetings, putting issues on meeting agendas, obtaining timely information and taking little part in the process of selecting directors. The size and composition of boards varied widely among Saudi joint stock corporations. The boards were generally weak in performing some of their functions and the independence of independent directors was questionable. They also tend not to have independent board committee for remuneration and nomination. Although the existence of an audit committee was mandatory in all listed Saudi corporations, the number of members in those committees was less than four. Virtually all the audit committees had accounting or finance specialists; are chaired by an independent director; take minutes of committee meetings; and had written rules governing the overall audit function. Audit committees, however, were weak in approving the appointment and replacement of the internal audit head and in discussing with him related matters; reporting on audit committee's activities provided at annual shareholder meeting; and accessing relevant information. Sample firms performed relatively poorly in the areas of information disclosure and transparency, particularly in relation to matters such as disclosing material foreseeable risk factors, providing channels for disseminating information for fair, timely and cost-efficient access to relevant information by users, disclosing governance structures, disclosing the remuneration of the board members and disclosing the financial and operating results of the company in the English language. Firms also were not yet making full use of web sites to disclose information in a timely fashion and to enhance transparency.

The mean values of the responses obtained from the first two samples (board of directors and CEOs) were higher than the mean values of the responses obtained from the last two samples (audit committee members and shareholders). That was a clear indication that the board of directors' members and the chief executive officers were more confident about the effectiveness of corporate governance in Saudi joint stock corporations than the audit committee members and the shareholders.

TABLE OF CONTENTS

LIST OF TABLES

LIST OF FIGURES

CHAPTER ONE:

INTRODUCTION

1.1. BACKGROUND

The subject of corporate governance has attracted increasing attention on both sides of the Atlantic in recent years (Aguilera and Jackson, 2003). Corporate governance is now the subject of much discussion in boardrooms, classrooms and the media (Cheffins, 1999).

Corporate governance received more attention due to a series of corporate failures that affected not only those directly connected with the companies concerned (i.e., directors, shareholders and auditors) but also those affected by its existence like employees, customers, suppliers and the environment. The first well-documented failure of governance was the South Sea Bubble in the 1700s, which revolutionized business laws and practices in England (Iskander et al., 1999).

The Asian financial crisis, which started with the devaluation of the Thai baht in July 1997, brought to the foreground the common occurrence of weak corporate governance which had allowed companies to engage in excessive over-leverage, some of which were aided by implicit state guarantees. The concepts of transparency, disclosure and accountability were largely ignored in the lead-up to the crisis as investors assumed a short-term outlook in order to derive increasing profits from the steadily rising regional financial markets.

The issue transcends national boundaries. Both the United States and Europe have had their share of questionable management decisions leading to the loss of billions of dollars, including Enron Corp. and Long Term Credit Management in the United States and Morgan Grenfell in Europe (Chambers, 2002). Australia has also not been immune as evident from the recent collapses of One.Tel Ltd and HIH Insurance Limited, a telecommunications and an insurance company, respectively. These are but a few of the more recent well documented cases that highlight the increasing importance of effective corporate governance. The financial crises in Asia, Russia, United States and Australia, amongst others, have shown that a lack of regard for core values of corporate governance does have a negative impact globally. Countries, markets and companies that have not been able to survive or that have fared badly in a crisis have one thing in common: poor corporate governance standards (Keong, 2002). Those financial crises showed that even strong economies lacking transparent control, responsible corporate boards and shareholder rights collapse quite quickly as investor's confidence erodes.

Empirical evidence (Fremond et al., 2002) suggests that good corporate governance increases the efficiency of capital allocation within and across firms, reduces the cost of capital for issuers, helps broaden access to capital, reduces vulnerability to crises, fosters savings provisions and renders corruption more difficult.

A careful study of corporate governance is important at the present time in Saudi Arabia because the future will be even more competitive than it is now. In emerging market economies the business environment lacks many elements needed for a competitive market and a culture of enforcement and compliance (Iskander et al., 1999). Saudi Arabia needs to take a long hard look at the way other countries' systems work and keep their own under review.

To remain competitive in a changing world, Saudi corporations must innovate and adopt their corporate governance practices so that they can meet new demands and new opportunities. The Saudi government also has an important responsibility for shaping an effective regulatory framework that provides for sufficient flexibility to allow the Saudi market to function effectively and to respond to expectations of shareholders and other stakeholders. The way these principles should be adopted is the responsibility of the government and the market participants.

1.2. OBJECTIVES OF THE STUDY

The main aims of this thesis are: (i) to review the ongoing practices of corporate governance in six developed and emerging markets that represent a broad and diverse sample that varies in terms of historical, legal, economic and cultural systems; (ii) to assess comprehensively the effectiveness of corporate governance in a unique developing country, Saudi Arabia; and (iii) to identify whether there are significant differences in the perceptions among the involved four samples (board of directors' members, chief executive officers, audit committee members and shareholders) towards the four mechanisms of corporate governance investigated in this study, namely: shareholders' rights; board of directors; audit committees and internal audit; and disclosure and transparency.

Saudi is a unique developing country because: (i) little is known about corporate governance in this country since this thesis, to the author's best knowledge, is the first to assesses comprehensively corporate governance practices in Saudi Arabia; (ii) Saudi Arabia has never had typical institutions (outside influences) of corporate governance, has never had a Code of corporate governance best practices and has never adopted the Principles of Corporate Governance that have been developed by the Organization of Economic Cooperation and Development (OECD) (1999, 2004), the International Monetary Fund (IMF), the World Bank and others; (iii) the influence of Islam, given that Saudi Arabia is the heartland of Islam, the birthplace of its history, the site of the two holy mosques and the focus of Islamic devotion and prayer.

This thesis is among the few comparable studies that have been conducted using developing or transition country data to analyse corporate governance systems and one which will add to the growing pool of scattered cross-country evidence. Example studies in the literature investigating corporate governance in developing countries are those with respect to Russia (Blasi and Shleifer, 1996; Black, 2001), Czech and Slovak Republics (Claessens, 1997; Claessens et al., 1996), China (Xu and Wang, 1997), a cross-section of transition economies (Aoki and Kim, 1995; Gray and Hanson, 1993), India (Chhibber and Majumdar, 1999; Khanna and Palepu, 1998; Sarkar and Sarkar, 1999; CII, 1998; Choudhury, 1999), Korea (Black, Jang and Kim, 2003) and others.

The assessment of the effectiveness of corporate governance is the outcome of the assessments of four corporate governance mechanisms, namely: shareholder rights; board of directors; audit committees and internal audit; and disclosure and transparency. As the intensity of adoption of these mechanisms in the Saudi publicly traded, joint stock, corporations increases corporate governance becomes more effective.

In other words, it is an objective to provide evidence from a developing and emerging Islamic economy, Saudi Arabia, on the role of shareholders, board of directors, audit committees and disclosure and transparency in enhancing the effectiveness of corporate governance in the Saudi joint stock corporations.

The characteristics of the four mechanisms of corporate governance being discussed in this thesis will be adopted from the recommendations of some international organizations such as the Organization of Economic Cooperation and Development (OECD) (1999, 2004), the International Monetary Fund (IMF), the World Bank, the Treadway Commission (1987), the Cadbury Committee (1992), the Blue Ribbon Committee (1999), The International Corporate Governance Network (ICGN) and other recommendations. However, more emphasis will be given to the OECD (1999, 2004) Principles of Corporate Governance since the OECD Principles have been widely accepted by many countries, organizations and regulators around the world and because the Principles were intended to assist non-members, too, as it has been stated by the OECD (1999: p.11) that;

> The Principles are intended to assist member and non-member governments in their efforts to evaluate and improve the legal, institutional and regulatory framework for corporate governance in their countries, and provide guidance and suggestions for stock exchanges, investors, corporations, and other parties that have a role in the process of developing good corporate governance.

The International Corporate Governance Network (ICGN) in their Statement on Global Corporate Governance Principles that was adopted in 1999 applauds the OECD Principles as a declaration of minimum acceptable standards for companies and investors around the world. The ICGN (1999: p.1) stated:

> The ICGN applauds the OECD Principles as a declaration of minimum acceptable standards for companies and investors around the world. Much of the document reflects perspectives promoted by ICGN representatives serving on the OECD's Ad Hoc Task Force on Corporate Governance, relying on the draft principles under discussion at the ICGN. The ICGN welcomes the OECD Principles as a remarkable convergence on corporate governance common ground among diverse interests, practices and cultures.

The World Bank also assists its client countries in the assessment of their corporate governance institutional frameworks and practices by preparing country corporate governance assessments using the OECD (1999) as a benchmark. The activities of the World Bank in corporate governance focus on the rights of shareholders, the equitable treatment of shareholders, the treatment of other stakeholders, disclosure and transparency and the duties of board members.

Since the publication of the OECD Principles in 1999, they have become the most widely accepted corporate governance benchmark and have influenced the drafting of other codes issued by international organizations, countries, companies and stock exchanges. Therefore, as has been said earlier, a special emphasis will be given to these principles as a benchmark to the Saudi corporate governance practices.

1.3. CONTRIBUTION TO KNOWLEDGE

This thesis differs from the related literature in several ways: by investigating the effectiveness of corporate governance; firm-level issues; all listed Saudi firms; no typical institutions (outside influences) of corporate governance; and religion effects.

First, most of the empirical literature on corporate governance has focused on the relationship between corporate governance and performance (Durnev and Kim, 2002; Klapper and Love, 2002; and Gompers et al., 2003), shareholder rights and performance (Holthausen et al., 1999; and Claessens et al. 2002), board of directors and performance (MacAvoy et. al., 1983, 1999; Black, 2000; and Burton, 2000), audit committee and performance (Wild, 1994; Klein, 2002; Vafeas and Theodorou, 1998) and disclosure and transparency and performance (Leuz et al. 2000; and Healy et al. 1999)

However, few authors have investigated the effectiveness of corporate governance and its elements discussed in this study, namely: shareholder rights, board of directors, audit committees and disclosure and transparency. In the Saudi Arabia case, it was thought to be too early to link corporate governance to firm performance because corporate governance in Saudi is still developing. Moreover, Saudi Arabia has not adopted any international recommendations or principles and, furthermore, Saudi has not yet produced its own best practices of corporate governance. Corporate governance in Saudi Arabia seems to be weak and the focus at this stage should be towards assessing corporate governance practices, helping regulators, organizations and corporations in understanding what has been meant by good corporate governance and providing the Saudi economy with some recommendations to develop and enhance corporate governance.

Second, previous authors have shown that better legal protection for investors is associated with higher valuation of listed firms relative to their assets or changes in investments (Claessens et al., 2002; La Porta et al., 2002; Wurgler, 2000), higher market value (La Porta et al., 1997) and larger listed firms in terms of their sales and assets (Kumar et al., 1999). Rajan and Zingales (1998) and Demirgüç-Kunt and Maksimovic (1998) also found that industries and firms that had better legal protection for investors rely more on external financing to fund their growth. Although these studies provide valuable insights into the effects of regulatory environments on stock markets, valuation and corporate financing, they do not address firm-level issues such as how corporate governance affects individual firm valuation within a country and they do not assess the effectiveness of corporate governance mechanisms.

Third, the data source for this study is all listed Saudi firms, both large and small, which enhances the generalizability of this study. The other researchers on emerging markets, however, either use a small single-country sample (Black, 2001) or multi-country samples that contain only the largest firms in each country (Durnev and Kim, 2002; Klapper and Love, 2002).

Fourth, the most widely known guidelines and principles of corporate governance are those developed by three international organizations, namely, the World Bank, the International Monetary Fund (IMF) and the Organization for Economic Co-operation and Development Principles of Corporate Governance (OECD) (PCSU, 2000). Countries adopting corporate governance rules more or less follow the standards set by those organizations. However, Saudi Arabia is not one of these countries and does not adopt or follow any of these organizations. Although some authors have investigated corporate governance in developing markets, this study will be the first to investigate how good corporate governance is in a developing country that does not adopt the corporate governance principles and does not have typical institutions (outside influences) of corporate governance.

Finally, this study could be classified as the first study investigating how religion (Islam) affects the adoption of such principles. Islam guides not only the lives of the people, but also the policies and functions of the government, which, in turn, regulate and impose corporate governance.

1.4. RESEARCH METHODOLOGY

The research methodology is a very important step in the research design process. The use of a particular methodology for a research project depends on the scope, purpose, target, population, etc. of the study as well as the resources available to the researcher. It is essential, therefore, that in order to achieve their objectives, researchers adopt the right methodology and select the right data collection techniques through which they can collect the required data within their available resources (Gill and Johnson, 2002).

In the process of the construction of the methodology, the author considered various factors that best reflect corporate governance practices in Saudi Arabia. The choice of the variables is based on the corporate governance mechanisms, namely: shareholders' rights, board of directors, audit committees and internal audit and disclosure and transparency.

Survey methodology currently is the most common approach used in a variety of fields ranging from economics and political science to environmental studies, marketing research, voting behaviour and health, among others, to study empirically the characteristics and interrelations of sociological and psychological variables (Roberts, 1999; Marsh, 1982; Young, 1996). The great advantage of this method is that it allows us to measure the attitudes and behaviours of large populations (e.g., country, state or city) by questioning a relatively small number of people, who are chosen through statistical/probabilistic procedures. Surveys, indeed, provide an efficient and economical means of determining facts about the economy and about people's attitudes, expectations and behaviours.

One of the most critical decisions in many social research investigations is the selection of the appropriate type of survey. However, the researcher has chosen the mail-out questionnaire survey method as the best method for this study relying on very few simple rules that made this decision easier. The researcher has used this judgment to balance the advantages and disadvantages of different survey types. In the decision process, the researcher asked a number of questions that guided this decision (see Chapter 6: Section 6.4.1).

The populations in this study have been divided into two categories: the entire (71) listed Saudi joint stock companies and 400 randomly selected shareholders. The subjects have also been classified into four groups: board members; chief executive officer CEO; audit committee members; and shareholders.

All questions in this instrument were constructed according to the Five-Point Likert Scale with a value of 1 indicating that the respondent strongly disagrees with a factor or statement and the highest number, 5, indicating that the respondent strongly agrees with a factor or statement based on the actual practice. The use of the standardised questions in this study allowed the findings from a number of respondents to be summarised, and this was also facilitated by the use of questions, which are amenable to numerical analysis such as rating scales. The Likert scale allows the respondent to choose one of five degrees of feeling about a statement from strong approval to strong disapproval. The questions were in the form of statements that seemed either definitely favourable or definitely unfavourable toward the matter under consideration.

The questionnaire has been divided into four parts, namely: shareholder rights, board of directors, audit committee and internal audit and disclosure and transparency, preceded by some short demographic (general) questions in order to provide sufficient motivation for the respondents to complete and to reduce the possibility of boredom which might induce the respondent to give up. The demographic questions have also been used in this questionnaire to break down the data when the survey was complete.

The pilot test was conducted to assure the clarity and effectiveness of the survey questions and to test the reliability and validity in order to revise the survey prior to final administration. To determine the effectiveness of the present survey questionnaire, the author pre-tested it before actually using it. The pilot test helped to determine the strengths and weaknesses of the survey concerning question format, sequence, wording, order, layout, validity, reliability and other matters.

Validity and reliability, the two major issues that a researcher must take into consideration when he or she uses a data gathering or measurement instrument, have been checked. The validity determines whether the research truly measures that which it was intended to measure or how truthful the research results are. In other words, does the research instrument allow the researcher to hit "the bull's eye" of the research objective. Reliability, on the other hand, is concerned with the accuracy and precision of a measurement procedure.

1.5. LIMITATIONS OF THE STUDY

The study has several limitations that should be taken into consideration at all levels of the research and analysis. First, the study was intended to evaluate the effectiveness of corporate governance in the Saudi joint stock corporations based on four mechanisms of corporate governance, namely: shareholders' rights, board of directors, audit committees and internal audit and disclosure and transparency. Other mechanisms that may be related to the effectiveness of corporate governance were not considered.

Second, the study focuses on the effectiveness of corporate governance of Saudi joint stock corporations. It does not deal with proprietorships, partnerships and close-held companies.

Third, the survey questionnaire reflects only the views, experiences and opinions of the targeted groups (board of directors, chief executive officers, audit committee members and shareholders) in Saudi joint stock corporations, which were restricted by the choice of questions used.

Fourth, the ANOVA test was based on an overall mean of a number of variables used for each corporate governance mechanism. Hence, the researcher is treating each variable as being of equal importance which might be debatable.

Fifth, any generalisation derived from the study's results is restricted to Saudi Arabia; cultural differences, social, accounting, corporate governance and investment environment distinctiveness from other countries may prevent wider generalisations.

Sixth, although tests for non-response bias were carried out using firm characteristics of industry and category of respondent and using late responses as a proxy for non-responses, the research lacks some other explicit controls for responder bias such as 'social desirability response bias'. Finally, other difficulties encountered in the study will be noted throughout the remaining chapters.

1.5. OUTLINE OF THE REMIANING CHAPTERS

This thesis is organized into nine chapters. The present chapter provides a background of the study, the objectives, research methodology and limitations of the study.

Chapter 2 provides an overview to corporate governance, including: definition of corporate governance; who sets corporate governance; the trends in corporate governance in a number of developed and developing countries, with emphasis that corporate governance of a particular country reflects its history, culture, regulatory structures and capital market characteristics.

Chapter 3 provides a background on the Saudi Arabian economy and development of corporate governance in the country by: discussing the development of the Saudi economy, highlighting the country's constitution, legislation and five-year development plans; providing some important facts relating to the Saudi Arabian oil and non-oil economy; clarifying that Saudi Arabian corporate governance is governed by four bodies: the Ministry of Commerce, the Saudi Arabian Monetary Agency (SAMA), the Saudi Stock Exchange (Tadawul) and some professional bodies; and explaining how Islam effects corporate governance in Saudi.

Chapter 4 investigates four mechanisms for effective corporate governance in Saudi Arabia. The chapter starts by developing a "four-legged chair" model that supports responsible, reliable, fair, accountable and transparent corporate governance system. Shareholders, board of directors, audit committees and disclosure and transparency are the four legs of the chair, supporting the one top goal of producing an effective corporate governance system in a firm.

Chapter 5 provides an overview of the theories, hypotheses and the literature that have been conducted in the field of corporate governance. The author relies on two related theories: the no one size fits all theory and the agency theory. The chapter finally introduces the hypotheses involved with this research.

Chapter 6 focuses on the methodology used to examine the effectiveness of corporate governance in Saudi Arabia. The chapter starts by providing different types of research methodologies and then concludes that the written survey method was the most appropriate methodology to be used in this study. Some characteristics, rules, ethics, strengths and weaknesses of survey research methodology were also discussed. The chapter is then divided into six major sub-sections, each of which discusses a different major step in administering the survey methodology used in this thesis.

The results of the study are detailed in Chapters 7 and 8. The analysis in the seventh chapter concentrates on the exploratory data analysis focusing on univariate and bivariate data analyses. The author looks at four main groups of techniques when considering the exploratory data analysis approach, which are frequencies, cross-tabulation, measuring location (central tendency) and measuring dispersion (spread). Chapter 8 relates to the hypotheses testing which could be referred to the second type of analysis, the confirmatory data analysis.

Chapter 9 presents a brief summary of the overall study and highlights its findings. Furthermore, a number of recommendations and suggestions for further research are provided.

CHAPTER TWO:

CORPORATE GOVENANCE OVERVIEW

2.1. INTRODUCTION

In our new millennium, the world is experiencing an unprecedented transition. The winds of sweeping changes have been reshaping the world politics, economies, environment, culture, and many other aspects. The end of the Cold War and the ensuing proliferation of the market economy, the resurgence of the world economic prowess, the economic conglomeration of Europe, the rise, fall and recovery of some economies, the rapid advancement in technology and the explosion of e-commerce are some of the highlighted events the world has been witnessing over recent decades. One of the significant implications of all these changes is that they pose a big challenge to business enterprises, particularly for those in developing countries and large global corporations that operate beyond national borders and play multiple functions with increasing power and influence. (Vernon, 1971; Ohmae, 1990; Korten, 1996; Karliner, 1997; Morss, 1997; and Clarke, 1998).

Monks and Minow (1995) defined a corporation as a mechanism established to allow different parties to contribute capital and expertise, for the maximum benefit of all of them. Oliver et al. (2003) suggested that corporations be governed by a system of checks and balances to make sure that their actions do not incur losses to the shareholders and stakeholders.

Corporations exist in different cultures with different norms and standards. It is therefore critical to recognize that managers, employees, business partners and other corporate stakeholders make decisions and choices that draw upon their cultural background and identity-group perspectives (Thomas and Ely 1996). The corporate governance of a particular country reflects its history, culture, regulatory structures and capital market characteristics (Keong, 2002). As a Saudi academic, this thesis will be about a system by which companies are directed, controlled and operate in Saudi Arabia.

In this chapter, an overview of corporate governance is carried out including: definition of corporate governance; who sets corporate governance; and the trends in corporate governance in a number of developed and developing countries.

2.2. DEFINITION

The etymology of "governance" comes from the Latin words *gubernare* and *gubernator*, which refer to steering a ship and to the steerer or captain of a ship. The word "governance" comes from the old French "gouvernance" and means control and the state of being governed (Farrar, 2001).

Corporate governance has succeeded in attracting a good deal of public interest because of its importance for the economic health of corporations and the welfare of society, in general. However, the concept of corporate governance is defined in several ways because it potentially covers many activities having direct or indirect influence on the financial health of corporate entities. As a result, different people and organizations have presented different definitions, which basically reflect their special interests in the field.

Milton Friedman (2002), an economist and Noble laureate, said that corporate governance is to conduct the business in accordance with owners or shareholders' desires, which generally will be to make as much money as possible, while conforming to the basic rules of the society embodied in law and local customs. This definition is based on the concept of market value maximization that underpins shareholder capitalism.

The Organization for Economic Co-operation and Development (OECD) (1999) defined corporate governance as the system by which business corporations are directed and controlled. According to them the corporate governance structure specifies the distribution of rights and responsibilities among different participants in the corporation, and spells out the rules and procedures for making decisions on corporate affairs. By doing this, it provides the structure through which the company objectives are set, and also provides the means of attaining those objectives and monitoring performance.

The World Bank (1999) defined corporate governance from two different perspectives. From the standpoint of a corporation the emphasis is put on the relationships between the owners, management board and other stakeholders (the employees, customers, suppliers, investors and communities). Major significance in corporate governance is given to the board of directors and its ability to attain long-term, sustained value by balancing these interests. From a public policy perspective, corporate governance refers to providing for the survival, growth and development of the company, and at the same time its accountability in the exercise of power and control over companies. The role of public policy is to discipline companies and, at the same time, to stimulate them to minimize differences between private and social interests (World Bank, 1999).

Monks and Minow (2001: p.1) defined corporate governance

> (Corporate governance) is the relationship among various participants in determining the direction and performance of corporations. The primary participants are (1) the shareholders, (2) the management, and (3) the board of directors.

An article published in the June 21, 1999 issue of the *Financial Times* quoted J. Wolfensohn, President of the World Bank, as saying that "Corporate Governance is about promoting corporate fairness, transparency and accountability".

According to some other authors, corporate governance means doing everything better, improving the relationships between companies and their shareholders, improving the quality of outside directors, encouraging people to think long-term, ensuring that the information needs of all stakeholders are met and ensuring that executive management is monitored properly (Monks and Minow 2001; Keong, 2002; Chambers 2002; and Charkham 1995).

Gregory (2001) in her very-well-done comparison study entitled, "International Comparison of Corporate Governance Guidelines and Codes of Best Practice: Developed Markets," described corporate governance as,

> "Corporate Governance refers to that blend of law, regulation, and appropriate voluntary private-sector practices which enables the corporation to attract financial and human capital, perform efficiently, and thereby perpetuate itself by generating long-term economic value for its shareholders, while respecting the interests of stakeholders and society as a whole" (Gregory, 2001, pp. i).

According to Olin (2001) corporate governance is a broad term that encompasses rules and market practices that determine how companies make decisions, the transparency of their decision-making processes, the accountability of their directors, managers and employees, the information they disclose to investors and the protection of minority shareholders. From the author's point of view, corporate governance can be defined as the set of rules and incentives by which the management of a company is directed and controlled in order to maximize the profitability and long-term value of the firm.

In Saudi Arabia, the contractual governance of management behavior, as one example, is necessarily incomplete and direct monitoring will be under-provided (Al-tweejri, 2002). Hence, management is in the position to seize residual control rights and may appropriate the shareholders' investment returns. If left unregulated, shareholders will under-provide finance and companies will not be able to take advantage of all value enhancing investment opportunities. Thus the codification of corporate governance into national law or codes of best practice in Saudi Arabia becomes a necessary and effective means of alleviating under-investment and limiting the implied agency costs.

2.3. CODES OF GOOD CORPORATE GOVERNANCE

Codes of good corporate governance present a comprehensive set of norms on the role and composition of the board of directors, relationships with shareholders and top management, auditing and information disclosure, as well as the selection, remuneration and dismissal of directors and top managers. The codes serve to improve the overall corporate governance of corporations, especially when legal environments fail to ensure adequate protection of shareholders' rights (OECD, 1999; Aguilera et al., 2000; Keong, 2002).

An important factor affecting the issuance of the codes is the issuer (Sullivan, 2000). Issuers can be stock exchanges, governments, director associations, manager associations, professional associations or investors. Differences in who issues the code denote differences in the enforcement of the codes. For instance, government and stock market issuers might exert coercive pressure for the adoption of the codes of good governance, whereas associations and investors might apply normative pressures for adoption (Sullivan, 2000).

2.3.1. Who sets the codes of corporate governance?

The majority of countries adopting corporate governance rules more or less follow the standards and guidelines of corporate governance set by three international organizations: the Organization for Economic Co-operation and Development Principles of Corporate Governance (OECD), the World Bank and the International Monetary Fund (IMF).

2.3.1.1. The Organization for Economic Co-operation and Development (OECD)

In 1998, the Organization for Economic Co-operation and Development (OECD) established an Ad-Hoc Task Force on Corporate Governance to develop a set of non-binding core principles on corporate governance that reflected the views of its 30 member countries.[1] The Task Force concluded its work in April 1999. The Principles and associated recommendations were subsequently approved by the OECD and endorsed by ministerial level representatives of member nations at their annual meeting on May 26 and 27, 1999.

The OECD principles of corporate governance are general guidelines for regulating the entity (Fremond et al., 2002). According to the OECD Task Force

[1] Australia, Austria, Belgium, Canada, Czech Republic, Denmark, Finland, France, Germany, Greece, Hungary, Iceland, Ireland, Italy, Japan, Korea, Luxembourg, Mexico, Netherlands, New Zealand, Norway, Poland, Portugal, Slovak Republic, Spain, Sweden, Switzerland, Turkey, United Kingdom, and the United States

that drafted them, the Principles were devised with four fundamental concepts in mind: responsibility, accountability, fairness and transparency. The OECD principles are primarily concerned with listed companies. They are organized into five sections, (I) the rights of shareholders, (II) the equitable treatment of shareholders, (III) the role of shareholders in corporate governance, (IV) disclosure and transparency and (V) the responsibilities of the board (OECD, 1999).

2.3.1.1.I. The Rights of Shareholders

The rules emphasize that shareholders have secure ownership, the right to full disclosure of information, voting rights and participation in decisions concerning fundamental corporate changes such as the sale or modification of corporate assets including mergers and new share issues. Markets for corporate control should be efficient and transparent and shareholders should consider the costs and benefits of exercising their voting rights (OECD, 1999).

2.3.1.1.II. The Equitable Treatment of Shareholders

"All shareholders of the same class should be treated equally" (OECD, 1999: p.19), including minority and foreign shareholders and should have the opportunity to obtain effective redress for violation of their rights. This principle emphasizes the protection of minority and foreign shareholders rights with full disclosure of material information. It ensures the setting up of systems that keep insiders, including managers and directors, from taking advantage of their roles, insider trading is prohibited and members of the board and managers should be required to disclose any material interest in transactions (OECD, 1999).

2.3.1.1.III. The Role of Stakeholders in Corporate Governance

In addition to the shareholders, the OECD also recognizes the right of stakeholders. The principles stress that stakeholders (in particular creditors, employees and consumers) play an integral part in shaping the decisions of a company. Principle III states that,

> ...the corporate governance framework should encourage active co-operation between corporations and stakeholders in creating wealth, jobs and the sustainability of financially sound enterprises (OECD 1999: p. 35).

Employees are usually the important stakeholders that determine how companies perform and take decisions. Thus the corporate governance framework must ensure that the rights of stakeholders are protected by law and respected. Stakeholders participating in the corporate governance process should have access to relevant information (OECD, 1999).

2.3.1.1.IV. Disclosure and Transparency

The OECD principles ensure that "...timely and accurate disclosure is made on all material matters regarding the corporation, including the financial situation, performance, ownership and governance of the company" (OECD, 1999: p.21) including board of directors and their remuneration. The guidelines also specify that annual audits should be performed by independent auditors in accordance with high quality standards of accounting, financial and non-financial disclosure. Channels for disseminating information should provide fair, timely and cost efficient access to relevant information by users (OECD, 1999).

2.3.1.1.V. The Responsibilities of the Board

> The corporate governance framework should ensure the strategic guidance of the company, the effective monitoring of management by the Board, and the Board's accountability to the company, shareholders and stakeholders (OECD, 1999: p. 22).

These include concerns about corporate strategy, risk, executive compensation and performance, as well as accounting and reporting systems. Board members should act on a fully informed basis, in good faith, with due diligence and in the best interests of the company and its shareholders. The Board should also ensure compliance with applicable laws and take into account the interests of the stakeholders. Finally, the Board should be able to make objective judgments on corporate affairs, independent from management (OECD, 1999).

The OECD principles are not binding. Their purpose is to serve as a reference point. They are evolutionary in nature and should be reviewed in light of significant changes in circumstances (OECD, 1999). The Principles are primarily intended to provide assistance to governments as they pursue their own efforts to evaluate and improve the legal, institutional and regulatory framework that affects corporate governance. They also provide guidance and direction for stock exchanges, investors, corporations and other parties that have a role in developing good corporate governance.

The OECD Principles were based on different views from a number of various developed countries. Thus, they represent a basic consensus on corporate governance requirements and describe existing rules, rather than propose radical changes. As a result, the OECD Principles are an excellent starting point for the examination of a sound framework in emerging countries. The principles mainly focus on publicly traded companies. However, to the extent they are deemed applicable, they may be also useful for non-traded companies, such as privately held and state-owned enterprises. In brief, the OECD Principles emphasize that good corporate governance can be achieved through a combination of regulatory and voluntary private actions.

2.3.1.2. The World Bank

The Financial Stability Forum, the G7 (Canada, France, Germany, Italy, Japan, UK and USA)[2], the G20 (G7 plus Argentina, Australia, Brazil, China, India, Indonesia, Korea, Mexico, Russia, Saudi Arabia, South Africa, Turkey and EU)[3] and the G22 (G7 plus Argentina, Australia, Brazil, China, Hong Kong SAR, India, Indonesia, Korea, Malaysia, Mexico, Poland, Russia, Singapore, South Africa and Thailand) have emphasized the role of minimum standards and codes in strengthening international corporate governance.

At the international level, standards enhance the transparency, identify weaknesses that may contribute to economic and financial vulnerability and foster market efficiency and discipline. At the national level, standards provide a benchmark to identify vulnerabilities and guide policy reform. To serve best these

[2] Russia joined as full participant in 1998, which marked the establishment of the Group of Eight (G-8).
[3] G20 was formally established at the G-7 Finance Ministers' meeting on September 26, 1999 (www.g20.org).

two objectives, the scope and application of such standards need to be assessed in the context of a country's overall development strategy and tailored to individual country circumstances (Fremond et al., 2002).

The World Bank has always encouraged developing countries to adopt international best practices and implement legal and regulatory reforms. It is not in the business of setting standards or creating codes, rather it gives necessary support on national, regional and global levels (Iskander et al., 1999).

At the national level, the World Bank has supported a series of country self-assessments that identify strengths and weaknesses in corporate governance that helped countries to establish priorities. The objective of the assessments is to strengthen regulatory reform and enforcement while fostering private voluntary actions. This is consistent with the Bank's comprehensive development framework that emphasizes good corporate governance as a key factor in development effectiveness. The framework stresses the importance of the private sector (local and foreign), as a major player in the development process. It also calls for the participation of stakeholders in the design and implementation of a comprehensive reform strategy (Iskander et al., 1999).

At the national level, the World Bank has co-sponsored with other multinational agencies (e.g., OECD) a series of round-tables addressing government officials, legislators, regulators, local and foreign firms, investors and rating agencies to help craft a consensus for reform. The World Bank has worked closely with the OECD to broaden the corporate governance beyond OECD countries (Iskander et al., 1999).

2.3.1.2.1. The Report on Observance of Standards and Codes (ROSC)

The corporate governance team of the Private Sector Advisory Services Department (PSAS) after consultations with a number of emerging market governments uses the OECD Principles as the benchmark in the assessment process. The OECD Principles were agreed upon by a large number of countries (30) of varied legal, economic and cultural traditions and after extensive consultation with the World Bank, the IMF and representatives of the business community from Japan, Germany, France, UK and the US, as well as international investors, trade unions and other interested parties. As such, they represent the minimum standard that countries with different traditions could agree upon, without being unduly prescriptive.

To assess countries, the World Bank has produced a questionnaire in the form of a template. It is structured along the five chapters of the OECD Principles. The objective of having the template is to facilitate the gathering of information necessary to formulate a diagnostic of the institutional framework underlying corporate governance, as well as prevailing practices and enforcement. For each OECD Principle, a set of questions has been prepared to assess the compliance of the country under assessment. Most of the questions could be answered in "yes" or "no", to allow benchmarking (Fremond et al., 2002).

The template includes a section on the ownership structure of the assessed country because this is an important determinant of corporate governance practices. It endeavors to identify pyramid structures, cross-shareholdings and business groups and gathers information on the divergence between cash flow rights and voting rights. While the OECD Principles are mainly concerned with the rights of shareholders and stakeholders, disclosure and the responsibilities of insiders, the template also addresses the issue of institutional capacity (Fremond et al., 2002).

The format of the assessments allows for systematic benchmarking across countries and regions. It is divided into four parts: (i) executive summary; (ii) capital market overview and institutional framework; (iii) principle by principle review including policy recommendations; and (iv) institutional strengthening.

2.3.1.2.2. Insolvency and transparency in codes of corporate governance

The World Bank has emphasized the inclusion of insolvency and creditors rights besides transparency in codes/rules of corporate governance.

2.3.1.2.2.1. Insolvency and creditors rights

In an effort to improve the stability of the international financial system after the South East Asian Crisis, the World Bank led an initiative to identify principles and guidelines for meaningful insolvency systems and for the strengthening of related debtor-creditor rights in emerging markets.

Insolvency systems provide a pre-determined set of rules and institutions concerned with the recognition of insolvency, the resultant liquidation or rehabilitation of the insolvent firm and the allocation of the financial consequences between the stakeholders. The insolvency systems also permit lenders to price risk more accurately and encourage cash flow lending rather than relationship or politically directed lending and discipline managers to allocate scarce resources efficiently.

2.3.1.2.2.2. Transparency in accounting and auditing systems

In order to have transparent, timely and reliable corporate financial reporting and as part of the Reports on the Observance of Standards and Codes (ROSC) initiative, the World Bank is undertaking reviews of compliance with accounting and auditing standards in a number of countries. It is intended to provide a basis for comparing practice in the countries reviewed to both national and international accounting and auditing standards which, in turn, will facilitate cross-country comparison and the design of programs to strengthen corporate financial reporting. More specifically, the objectives of the review are to assess the comparability of national accounting and auditing standards with International Accounting Standards (IAS) and International Standards on Auditing (ISA), respectively; and the degree to which corporate entities comply with established accounting and auditing standards in the country.

Furthermore, the International Finance Corporation (IFC), being a member of the World Bank Group, has also promoted better corporate governance by requiring that the firms in which it invests, practise sound corporate governance and insist on proper internal controls and reporting. This applies particularly on developing stock and bond markets (Iskander et al., 1999).

2.3.1.3. International Monetary Fund (IMF)

The IMF is an international organization of 184 member countries. It was established in 1945 to promote international monetary cooperation, exchange stability, and orderly exchange arrangements; to foster economic growth and high levels of employment; and to provide temporary financial assistance to countries to help ease balance of payments adjustment (IMF).

In addition to the IMF's contribution in the Report on Observance of Standards and Codes (ROSC) of the World Bank, the IMF has developed codes of good practice mainly for the transparency of governments' fiscal and monetary policies.

2.3.1.3.1. Greater Fiscal Transparency

The IMF is encouraging its member countries to implement a Code of Good Practices on Fiscal Transparency. The Code stresses: responsibilities of government should be clear; information on government activities should be provided to the public; budget preparation, execution and reporting should be undertaken in an open manner; and fiscal information should attain widely accepted standards of quality and be subject to independent assurances of integrity. The Code sets out what governments should do to meet these objectives in terms of principles and practices.

The Code of Good Practices on Fiscal Transparency is based on four general principles:

- *Clarity of Roles and Responsibilities.* The government sector and/or its public sector agencies should be distinguished from the rest of the economy. Policy and management roles within the public sector should be clear and publicly disclosed. There should be a clear legal and administrative framework for fiscal management.

- *Public Availability of Information.* The public should be provided with full information on the past, current and projected fiscal activity of the government. A commitment should be made to the timely publication of fiscal information.

- *Open Budget Processes.* The budget documentation should specify fiscal policy objectives, macroeconomic framework and policy basis for the budget as well as identifiable major fiscal risks. Budget information should be presented in a way that facilitates policy analysis and promotes accountability. Procedures for the execution and monitoring of approved expenditure and for collecting revenues should be clearly specified. There should be regular fiscal reporting to the legislature and the public.

- *Assurance of integrity.* Fiscal data should meet accepted data quality standards and fiscal information should be subjected to independent scrutiny. There should be mechanisms in place which provide assurances to the public about data integrity.

2.3.1.3.2. Code of Good Practices on Transparency in Monetary and Financial Policies

The IMF has developed a Code of Good Practices on Transparency in Monetary and Financial Policies. The design of good transparency practices in the Code rests on two principles. First, monetary and financial policies can be made more effective if the public knows the goals and instruments of policy and if the authorities make a commitment to meeting them. Also good governance calls for central banks and financial agencies to be accountable, particularly where the monetary and financial authorities are granted a high degree of autonomy.

The Code was developed in the context of the development of standards and codes for public disclosure and transparency practices designed to strengthen the international monetary and financial system. It calls for greater transparency of commercial banks, securities firms, insurance firms, central banks etc.

An increasing number of countries are taking the next step of participating in a fiscal module of a *Report on Observance of Standards and Codes* (ROSC), which the IMF and the World Bank have developed as a means of assessing the extent to which countries meet the requirements of standards and codes in core areas and providing information to the public. Fiscal ROSCs comprise a summary description of practices prepared by the IMF staff based on the completed questionnaire, together with a staff commentary including recommendations for improvement. When fiscal ROSCs become out of date, a ROSC reassessment will be done to replace the original ROSC.

As of March 2003, 48 ROSC fiscal transparency modules have been published on the IMF website, and 11 have published updates. Around 20 new or revised fiscal transparency ROSCs are planned for each year (IMF, 2003).

2.4. CORPORATE GOVERNANCE WORLD WIDE

In the late 1990's, the issue of corporate governance has received more global attention than it would have in the light of a series of corporate failures (Iskander et al., 1999). Furthermore, the recent crises and bankruptcies faced by various firms in different countries, including East Asia, Russia, United States, United Kingdom, Australia and others raises a question: what went wrong?

Those failures, amongst others, have shown that a lack of regard for core values of corporate governance does have a negative impact globally. Countries, markets and companies that have not been able to survive or that have fared badly in a crisis have one thing in common: poor corporate governance standards (Keong, 2002).

Over the last decade a number of reports has been commissioned into the subject of corporate governance and as a result a number of codes of best practice has emerged. The purpose of these codes of best practice is to increase transparency and accountability in the manner in which companies are governed. By 2004, thirty-seven countries had issued codes of good governance (Appendix 5). This excludes other developed and emerging countries that are in the process of issuing their Code of Good Practice for Corporate Governance. A complete list of these countries can be found at the World Bank, OECD, and European Corporate Governance Networks.

Since this is the first empirical study investigating corporate governance in Saudi Arabia, it will provide a comparative analysis of corporate governance, as an issue of concern in some developed and developing countries. It will provide a general perspective of what the trend has been in the last two decades in order to benefit from those countries in the development of the Saudi's corporate governance rules and codes of good governance practice. Six countries have been identified and classified into three groups based on the state of development of their corporate governance, similarities of their economic environment to that of the Kingdom of Saudi Arabia and the possibility of Saudi Arabia benefiting from their established organizations. The three groups are as follows:

- ✓ The United States of America and United Kingdom;
- ✓ France and Germany; and
- ✓ Korea and Malaysia.

2.4.1. The United States of America

In the United States of America each company is incorporated under the laws and jurisdiction of one of the states. Expectations and requirements of companies vary from state to state (Tricker, 1984).

Between 1880 and 1930, the United States experienced a 'corporate revolution' and the 'outsider/arms-length' system of ownership took shape as part of this process (Means, 1962). According to Bishop (1994), corporate governance in the USA has its roots in the public stock markets of the late 19th century. American shares are mostly owned by individuals. These individuals typically hold a tiny slice of the equity of a firm which gave them little incentive to incur the costs of monitoring managements. Throughout the 19th century, there were isolated examples of companies with widely dispersed shareholdings and well-developed management. Industrial enterprises almost invariably were privately held with family control being very much the norm (Lamoreaux, 1955). Lamoreaux added that a merger wave that peaked at the turn of the 20th century heralded a distinct change in approach. The mergers were often financed in part by public offerings of shares which served to disperse share ownership among a wide range of investors. The process of consolidation thereby created situations where those making managerial decisions did not own a substantial shareholding block (Lamoreaux, 1955).

Change was also evident in large companies that remained family-dominated. By the end of World War I, family members were typically working closely with salaried executives rather than attempting to manage their own businesses (Chandler, 1990). Despite the trends affecting US business enterprises, the family did not disappear completely from the corporate landscape. In the mid 1990's in over one -fifth of America's largest one thousand public companies, the founding family retained significant influence (Cheffins, 2001). Nevertheless, in "The Modern Corporation and Private Property," it was mentioned that while the law treated shareholders as a company's owners, delegation of managerial authority to professionally trained executives was common practice and there was true "separation of ownership and control" (Berle and Means, 1932).

The first code of good governance in the United States appeared in the late 1970's. It denoted the transition from the conglomerate merger movement of the 1960s to empire-building behavior by management through hostile takeovers (Aguilera, 2003).

In the context of charges and counter charges surrounding the takeover movement, the Business Roundtable (BRT) issued a report in January 1978 entitled: "The Role and Composition of the Board of Directors of the Large Publicly Owned Corporation". The Business Roundtable Report chaired by Austin, CEO of Coca-Cola, turned out to be a claim for the legitimacy of private power and the enforcement of accountability. The Report stated that the directors' main duties are: overseeing the management and board selection and succession; reviewing the Codes of Good Governance Worldwide, the company's financial performance and allocating its funds; overseeing corporate social responsibility and ensuring compliance with the law (Charkham, 1995).

In the U.S., when an investor is unhappy with the manner in which management deals with the business of the company, he/she dumps his/her shares. This is called the "Wall Street Walk". Results from a poll in *Investor's Business Daily* found that only one in 13 Americans have high confidence in the honesty and integrity of corporate chief executives and chief financial officers (Investor's Business Daily, May 12, 2003).

In the United States and other developed markets, the main methods of solving agency problems are the legal protection of minority investors, the use of Boards of directors as monitors of senior management and an active market for corporate control, "takeovers." The strength of these methods is determined by securities regulations, corporate laws, charter provisions, etc. However, the recent corporate failures of Enron, WorldCom, Global Crossing, Adelphia, Qwest, etc. have obviously shown that sometimes rules, laws, market discipline and use of Boards can all fail, if not effectively and properly implemented.

Rules, regulations, laws and provisions are set to define the power of corporate governance. Firms, in turn, have wide latitude in setting the rules for shareholder voting and the election of Board of directors, duties and responsibilities of Board of directors, the effectiveness of Boards, etc. If they choose, managers can use this leeway to make it more difficult for shareholders to exercise any influence or control (Stein, 1988).

According to Bhide (1994) and Bishop (1994), the USA regulatory model for protecting investors is the most comprehensive and well enforced in the world. The origins of the system can be traced to the extensive losses suffered by the public during the crash of 1929. Responding to the outrage of voters, Congress passed the Securities Exchange Act of 1934 and created the Securities Exchange Commission to regulate the stock exchanges conduct.

Over the years, Congress has also sought to protect investors by regulating the financial institutions that manage funds. For example, the Investment Company Act 1940, which followed the collapse of Investment Trusts, set minimum levels of diversification for mutual funds and precluded them from holding more than 10 per cent of a company's stock.

The Sarbanes-Oxley Act (2002) '*the Act*', which became law on July 2002, included several corporate governance related provisions, along with new corporate disclosure requirements and auditor regulatory and securities law enforcement measures (John et al, 2002). Most of the provisions related to board structure and function required for implementation the Securities and Exchange Commission (SEC) rule-making, which has for the most part now been completed. However, certain important provisions relating to audit committees are to be effectuated through the self-regulatory process of stock market listing standards (mandated by new "national market system" provisions) (John et al, 2002; and Antin et al, 2002).

The New York Stock Exchange (NYSE) has submitted to the Securities Exchange Commission (SEC) (initially on August 16, 2002 and amended on October 7, 2002 and March 12 and April 4, 2003) proposed listing requirements which create a wide-ranging set of corporate governance standards, supplementing the standards it had already established (which related primarily to audit committees and shareholder approval requirements) (John et al, 2002). They include provisions intended to satisfy the requirements regarding audit committees mandated by the Act. As proposed, listed companies will be required as a general rule to comply with many of these requirements within six months following the Securities and Exchange Commission (SEC) approval of the proposed requirements but will not be required to comply with the new requirements regarding board and committee composition until 18 months after SEC approval (subject to extension of this deadline in certain circumstances) (Antin et al., 2002).

The NASDAQ Stock Market (Nasdaq) has also submitted to the SEC (initially on October 9, 2002 and amended on March 11, 2003) more than 25 new corporate governance requirements for listing, supplementing its pre-existing listing standards (which also related primarily to audit committees and shareholder approval requirements). Generally, they cover the same subjects as the NYSE proposals and they include provisions intended to satisfy the requirements regarding audit committees mandated by the Act (PricewaterhouseCoopers, 2003).

2.4.1.1. Teachers Insurance and Annuity Association College Retirement Equities Fund (TIAA-CREF)

The Teachers Insurance and Annuity Association College Retirement Equities Fund TIAA-CREF (2000) believed certain principles were the benchmark of an equitable and efficient corporate governance structure. According to TIAA-CREF (2000), good corporate governance must be expected to maintain an appropriate balance between the rights of shareholders, the owners of the corporation, and the need of the board and management to direct and manage the corporation's affairs free from non-strategic short-term influences.

TIAA-CREF (2000) believed that good governance practices are important to encourage investments in countries and companies in a global economy where gaining access to capital markets is increasingly seen to be very competitive. As a consequence, there are now accepted principles of global corporate governance, such as those employed by the OECD, the IMF and the World Bank. These principles recognize that not every country needs to adopt a "one-size-fits-all" code of practice. Therefore, the TIAA-CREF believed that shareholders might reasonably expect country and company practice to include the following characteristics in their developments of good practice (TIAA-CREF, 2000).

- Appropriate structures of accountability of the company to its owners.
- Independent oversight of managers and accounts (including independent audits of financial statements based on high quality accounting principles).
- Fair and equitable treatment for all shareholders (an issue that can be particularly relevant when there is a controlling shareholder).
- Fair voting processes that in practice assure disclosure of all facts material to each vote being taken, and that enable shareholders to exercise their ownership rights in relation to their economic interest.
- Prohibition of insider trading and abusive insider trading.
- Open, efficient, and transparent markets for corporate control.
- Timely disclosure of financial and operating results of the company, material developments and foreseeable risk factors, and matters related to corporate governance. Disclosures related to corporate governance should

include interested party transactions and any capital structures or arrangements that enable certain shareholders to obtain control disproportionate to their equity ownership; significant information about board members and key executives, including their compensation; and information describing governance structure and policies.

- Regulatory and legal recourse if principles of fair dealing are violated.

2.4.1.2. The California Public Employees Retirement System (CalPERS)

The CalPERS, America's largest public pension fund managing assets of more than US$143 billion (Carlson, 1998), was established in 1932 as a defined benefit plan. A defined benefit plan is a retirement program that sets a benefit calculated on a formula, often a percentage of final average pay, times years of service based on retirement age.

The CalPERS began their corporate governance program in the early 1980's, as a direct response to the takeover frenzy in corporate America. It began simply as objections by a few share-owners to certain company actions that were considered to be self-serving. Companies created anti-takeover devices and procedural obstacles that were viewed more as protecting the corporate status quo than serving the long-term interests of shareowners (Carlson, 1998).

The CalPERS strongly believes that each market throughout the world should adopt corporate governance principles that are appropriate for that market. Ideally, these principles should be developed by the market's participants themselves, through cooperative action and consensus (see CalPERS).

The CalPERS defined corporate governance to be the relationship among valuable participants in determining the direction and performance of corporations (Carlson, 1998). The primary participants are shareholders, company management and the board of directors. The definition does not expressly mention other stakeholder groups (the community, company employees, suppliers, and customers). In CalPERS' point of view, companies that operate with long-term shareowner returns, as the primary goal, will ultimately also reward other stakeholders.

In late 1989, CalPERS began working closely with the US Securities and Exchange Commission (SEC). This relationship led to the 1992 reform of executive compensation disclosure and proxy solicitation reforms (Carlson, 1998). In early 1997, the CalPERS Investment Committee approved CalPERS' Global Governance Principles. In late 1999, the CalPERS Investment Committee analysed other newer global governance principles (see CalPERS).

In March 1996, CalPERS' Board formally adopted its International Corporate Governance Program (Gillan, 1997). As the first step in implementing this program, in December 1996 the Board adopted a set of Global Governance Principles. The Principles focus on 6 basic concepts that are fundamental to free and fair markets throughout the world (Gillan, 1997). Moreover, the Principles reflect the core of what the corporate/shareholder relationship should be. Specifically, the 6 Global Principles are: (i) accountability; (ii) transparency; (iii) equity; (iv) voting method improvements; (v) code of best practices; and (vi) long-term vision (CalPERS, 1999). Those principles (CalPERS, 1999) are:

- Directors should be accountable to shareholders, and management accountable to directors. To ensure this accountability, directors must be accessible to shareholder inquiry concerning their key decisions affecting the company's strategic direction.
- Information about companies must be readily transparent to permit accurate market comparisons; this includes the notion of some globally accepted minimum accounting standard.
- Investors – even minority and foreign investors – must be treated equitably and upon the principle of one share/one vote.
- Proxy materials should be written in a manner designed to provide shareholders with the information necessary to make informed voting decisions. Similarly, proxy materials should be distributed in a manner designed to encourage shareholder participation. All shareholder votes, whether cast in person or by proxy, should be formally counted; vote outcomes should be formally announced.

- Each market should adopt its own Code of Best Practices; and, where such a code is adopted , companies should disclose to their shareholders whether they comply with it.
- Finally, CalPERS believes that corporate directors and management should have a long-term strategic vision, which at its core emphasizes sustained shareholder value. In turn, despite differing investment strategies and tactics, shareholders should encourage corporate management to resist short-term behavior by supporting and rewarding long-term superior returns.

Carlson (1998: p. 34) stated,

> In my opinion, effective governance is essential to the healthy growth of capitalism. The present system in the United States and internationally must continue to change in order to survive in the dynamic capital markets of the world economy. Our world cannot afford corporate owners who do not recognize themselves to be responsible with the same tenacity and ingenuity they employ to assert their shareowner rights. We are indeed at a critical, and exciting, place in the development of corporate governance.

2.4.1.3. Blue Ribbon Commission on Director Professionalism (NACD Report)

The Report of the National Association of Corporate Directors (NACD) was issued in 1996 and then reissued in 2001. The NACD argues that governance practices ought to be designed to promote a culture of "professionalism" for boards of directors and board members. The NACD Report (2000) recognizes that board practices are evolving and believes that they will continue to evolve in the direction it suggests. The Report's recommendations are purely voluntary (Gregory, 2001; NACD, 2000).

The NACD (2000: p.1) Report stated,

> A primary goal of the board, the CEO, and the audit committee is to create and maintain an audit committee that adds value to the board and the corporation. To add value, audit committees should oversee the organization's reporting, control, and audit processes. These tasks should be the essence of their purpose, the philosophy underlying selection of their committee members, and the focus of their processes.

2.4.1.3.1. The BRT Report

The Business Roundtable (BRT) released a revised "Principles of Corporate Governance" in May 2002. The principles discussed in the Report are intended to assist corporate management and boards of directors in their individual efforts to implement best practices of corporate governance and also to serve as guideposts for the public dialogue on evolving governance standards (BRT, 2002).

The Business Roundtable (2002) supports the following guiding principles.

- Boards of directors should select and oversee the CEO and other senior management in the competent and ethical operation of the corporation on a day-to-day basis.
- Managements should operate the corporation in an effective and ethical manner in order to produce value for stockholders.
- Management is responsible for producing financial statements that fairly present the financial condition and results of operations of the corporation, and making timely disclosures to investors.
- Boards and their audit committees should engage an independent accounting firm to audit the financial statements prepared by management and issue an opinion on those statements based on Generally Accepted Accounting Principles.
- It is the responsibility of the independent accounting firm to ensure that it is, in fact, independent, employs highly competent staff and carries out its work in accordance with Generally Accepted Auditing Standards.
- The corporation has a responsibility to deal with its employees in a fair and equitable manner.

2.4.1.4. Other Committees

Several Committees have been established in the US including the "Report of the National Commission on Fraudulent Financial Reporting" (commonly known as the Treadway Commission) strengthening the professionalization of the independent auditor (Treadway Commission, 1987), "Report to the Public Oversight Board of the SEC Practice Section" (see Public Oversight Board), "The Advisory Panel on Auditor Independence" (American Institute of Certified Public Accountants (AICPA), 1994) and the "Corporate Governance Rule Proposals Reflecting Recommendations from the NYSE Corporate Accountability and Listing Standards Committee" that was approved by the NYSE Board of Directors in August 2002 (NYSE, 2002).

The US market is a notable example in terms of applying corporate governance rules. According to the Nikkei Newspaper, June 15, 2003, about 36 Japanese corporations, as an example, adopted the US-style corporate governance structures. The move toward US-style governance, allowed under amendments to Japan's Commercial Code in April 2003, involves establishing three committees – audit, nominating and compensation. Many high profile international firms, such as Sony Corp., Mitsubishi, Hitachi Ltd. and Toshiba Corp. have made the changes to enhance their corporate image to overseas investors. Japanese firms who adopt US governance systems do so to enhance earnings, transparency and oversight of their operations by relying more on outside board members (Nikkei Newspaper, June 15, 2003).

According to a report in the Financial Times, June 5, 2003, the United States is continuing to up-date its corporate governance. The New York Stock Exchange (NYSE) in June 2003 adopted ten new rules that were being called the exchange's most sweeping governance up-date in 30 years. The rules were drafted to bring the NYSE's own governance practices in line with the requirements of its 2,500 listed companies (see NYSE).

2.4.2. United Kingdom

Tricker (1984) did a detailed historical study of the development of corporate governance in the United Kingdom since the Industrial Revolution. In his view, the evolution of the concept stems from the mid-nineteenth century, in particular, from the Companies Acts of 1855 and 1862. The developments that led to the corporate concept are threaded far back through the evolution of British trade and industry: indeed back to mediaeval England with the importance of individualism, freedom and self-regulation, contrasting with the more prescriptive rule of law in continental European countries.

Under British company law, each company is treated as an independent legal entity, irrespective of ownership or the locus of decision-making. The separation of ownership and control occurred later than it did in the US (Berle and Means, 1932). It began in the final few years of the 19th century when the British industrial and commercial firms first made a strong move towards public ownership, as dozens carried out initial public offerings (Prais, 1976).

With many British public companies, the one who founded the firms retained a sizeable percentage of the shares and played an important role in corporate decision- making. A commitment to personal ways of management was, therefore, perpetuated (Okochi et al., 1984).

Empirical studies of ownership and control patterns in the UK illustrate that there was a relative decline in the importance of family control of business as the 20th century progressed. Statistical data compiled in 1951 showed that there was a clear divorce between control and ownership for very large companies and that a "managerial evolution" was taking place (Florence, 1961). Florence said that between 1936 and 1951, the number of "very large" industrial and commercial companies that had an investor who controlled 20 percent or more of the voting equity fell from one out of three to less than one out of five. By the early 1960s, a number of firms Florence categorized as "owner-controlled" had ceased to qualify for inclusion in the group and it may be that the progressive erosion of family influence meant that by 1970 it would make little sense to talk of British personal capitalism.

As of 1970, forty-four of the UK's 100 largest manufacturing companies were either "family companies" (thirty) or were controlled by a non-British parent company (fourteen) (Channon, 1973). By the late 1980s, share ownership patterns were in fact moving closer towards the dispersed pattern evident in the US (Scott, 1990) as noted in the ownership patterns of the 200 largest industrial companies and the 50 largest financial businesses in the UK as of 1988.

Scott (1990) attributed this shift primarily to the decline of family control in UK companies. Clearly, then, by the time the 1980s drew to a close, "personal capitalism and family ownership had been swept away" and Britain had moved to a US-style corporate governance system with ownership separated from control.

The US and UK systems are characterized by active stock markets and the separation of ownership and control with some regrouping of ownership interests in the hands of institutional investors (Roe, 1994). There is a market for corporate control and a preference for boards dominated by non-executive directors (Whitman, 1999). The separation of ownership and control began after 1918 and is more pronounced in the US and the UK than in other countries (Berle and Means, 1932).

However, many significant companies in the United Kingdom remained under family control for longer periods and there were delays in the development of a professional managerial class (Cheffins, 1999).

2.4.2.1. The Cadbury Report 1992

The Cadbury Committee was set up in May 1991 by the Financial Reporting Council, the London Stock Exchange and the accountancy profession to address the financial aspects of corporate governance (Cadbury Report, 1992). It was then followed by the Committee on the Financial Aspects of Corporate Governance. The committee issued a draft report for public comment on 27 May 1992. Its final report, taking account of submissions made during the consultation period and incorporating a *Code of Best Practice* was published on 1 December 1992 (Chambers 2002; Cadbury Report, 1992; and Gregory, 2001).

The Code of Best Practice is directed to the boards of directors of all listed companies registered in the UK, and is enforced by a disclosure mechanism: listed companies have to report on their implementation of the Code's recommendations. The Stock Exchange and public opinion exercise pressure to ensure optimal follow-up of the Code rules (Cadbury Report, 1992).

The issuance of the Cadbury Committee Report in the United Kingdom marked the importance of corporate governance in the UK. The Cadbury Report, sometimes referred to as the *Magna Carta of Corporate Governance* (Gregory, 2001), which became very popular and widely accepted, deliberately challenged the effectiveness of voluntary regulation and British corporate democracy (Stiles et al., 1993). The recession in 1990 as well as a series of high-profile corporate failures, in which the weakness of internal corporate control was clearly a contributing factor, raised the issue of corporate accountability both in the public mind and in the House of Commons (Monks et al., 1992).

The Cadbury Report was issued because of concern about the perceived low level of confidence both in financial reporting and in the ability of auditors to provide the safeguards, which the users of the company reports sought and expected (Stiles et al., 1993; Charkham et al., 1999; and Cadbury Report, 1992). It also emphasized the need for independent directors, larger shareholder involvement, and the establishment of audit, compensation and nomination committees (Charkham et al., 1999). Moreover, sanctions were introduced to ensure that companies listed in the London Stock Exchange would comply with the Code.

The Cadbury Report's recommendations are highly codified, allowing both companies and stakeholders to benchmark best practices, as well as to be emulated by other agencies. The main principles of the Cadbury Report (Cadbury Report, 1992) comprise the following.

- Shareholders have a right and an obligation to exercise responsibilities. Owners should back management striving for long-term growth and intervene when problems arise.
- Existing UK Codes of Best Practice should be strengthened not weakened.
- Periodic review and up-dating of best practice guidelines should continue and reviewing bodies should include investors based outside the United Kingdom.
- The structure of the Board should be built upon the twin concepts of independence from management and accountability to shareholders. The following qualities are necessary to ensure a fully accountable and independent board: a separate Chairman and Chief Executive Officer with the

role of Chairman held by an independent director and a majority of independent directors. The U.K. corporations should certainly comply with Cadbury's recommendation that there be at least three non-executive directors on a board and that a majority of those non-executives should be independent directors. Key committees such as the audit, compensation and nomination committees composed exclusively of independent directors. Appropriate training for independent directors who face increased responsibilities associated with monitoring key functions such as audits, executive performance and compensation and corporate strategy. A properly focused board with directors occupying no more than two seats on other boards if they are employed full-time (i.e., a CEO at another company) or three if they are not (i.e., a retired CEO).

- Best practices in the UK should include several elements to strengthen management accountability to corporate owners through the director-shareholder relationship.

In May 1995, an implementation report was published, which indicated a considerable degree of compliance by larger corporations. Later reports complained about the administrative and others burdens resulting from the code, especially for the smaller companies.

The Cadbury Report was eventually followed by the Greenbury Commission Report (on director and executive remuneration), the Hampel Commission Report and the Combined Code of the Committee on Corporate Governance of the London Stock Exchange.

2.4.2.2. The Greenbury Report 1995

In 1995, a report was published by a Study Group into Directors' Remuneration (known as the 'Greenbury Report'). This report contained a code of best practice for determining and disclosing the remuneration of company directors. The Greenbury Code includes the following key recommendations (Greenbury, 1995).

- The compensation committee should be composed exclusively of independent members.
- Companies should annually outline their compliance with the Greenbury Code, including explanations if they do not comply.
- The annual compensation committee report should disclose pay details for all executive directors, including pension provisions, incentive pay, option plans, performance measurements, severance agreements and comparisons with similar companies.
- Executive pay should not be "excessive."
- Employment contracts should extend for no longer than one year so as to rule out multi-year golden handshake payouts in the event that an executive is dismissed or the company taken over.
- New long-term incentive plans should replace, not supplement, existing stock option plans.
- Performance-related pay should "align the interest of directors and shareholders," while performance criteria should be "relevant, stretching and designed to enhance the business." Upper limits should always be considered.
- Executive stock option awards should be phased rather than given all at once, and options should never be awarded at a discount.

A distinctive feature of the British corporate governance system is that it strongly resembles its counterpart in the United States. Both countries have well-developed equity markets, with most major business enterprises being quoted on a stock exchange and sharing an "outsider/arms-length" system of ownership and control (Moerland, 1995).

2.4.2.3. The Hampel Report 1998

In January 1998 the Committee on Corporate Governance, which was established to review the implementation of the Cadbury Report and to pursue any relevant matters arising from the Greenbury Report, published its final report, known as the "Hampel Report."

The Hampel Report (The Hampel Report, 1998: 7.3) noted,

> We intend to produce a set of principles and code of good corporate governance practice, which will embrace Cadbury and Greenbury and our own work. We shall pass this to the London Stock Exchange. We suggest that the London Stock Exchange should consult on this document, together with any proposed changes in the Listing Rules.

2.4.2.4. Other Committees

In mid 1998 the London Stock Exchange published a new code of corporate governance best practice, which drew on the Cadbury, Greenbury and Hampel Reports. This code became known as the 'Combined Code' (Combined Code, 1998). In December 1999, the provisions of the Combined Code were adopted by the Irish Stock Exchange, which annexed the Code to its Listing Requirements. As a result, Irish listed companies are now required to report on how they have applied the principles of the Combined Code or, where they have not applied the principles, to justify any instances of non-compliance in their annual reports (OECD, 2002). It is then a matter for shareholders and others to evaluate such explanations. The Combined Code sets out Principles of Good Governance under such headings as Directors, Directors' Remuneration, Relations with Shareholders, Accountability and Audit, Internal Control and Audit Committees (OECD, 2002).

Following the publication of the Combined Code the Institute of Chartered Accountants in England & Wales (ICAEW) established a Committee charged with the task of providing guidance to company directors on the implementation of those principles of the Combined Code relating to internal control and risk management (ICAEW). The Committee published its report, known as the 'Turnbull Report' in September 1999 (Turnbull Report, 1999).

As a result of a series of high profile corporate failures in the U.K. and the U.S.A. in early 2002 (Enron, Worldcom etc.), the UK Government asked the UK Financial Reporting Council (FRC) to develop further the guidance on audit committees provided in the Combined Code (OECD, 2002). The FRC-appointed committee reported in January 2003. The committee's report sets out guidance to assist the boards of companies required to comply with the Combined Code in making suitable arrangements for their audit committees. The report also includes proposals for amendments to the Combined Code itself and includes a specimen audit committee charter. In reading the report, readers should note that compliance with the bold typeface content of the report is necessary in order to comply with the provisions of the Combined Code. As with the provisions of the Combined Code, non-compliance must be accompanied by an explanation as to the reasons for non-compliance (see FRC).

In January 2003, the 'Review of the Role and Effectiveness of Non-Executive Directors' ('The Higgs Report') was also published. This review was commissioned by the UK Secretary of State for Trade and Industry and the Chancellor. The report includes a number of recommended changes to the Combined Code, including the insertion of additional material in relation to company boards and non-executive directors (Higgs Report).

2.4.3. France

The move towards an increased focus on corporate governance by French and German companies is a recent phenomenon (Whittington and Mayer 2000). The use of the conglomerate form, the internal organization of the firm based on the multi-divisional structure, and the diversification in many related and unrelated business activities characterized companies in France at least until the mid-1990s (Richter 1997; Whittington and Mayer 2000). This organizational structure was broadly similar to its counterparts in the U.K. and the U.S. (Chandler 1990).

With the increase of private companies, the opening of markets to international investors, and a shortage of equity financing, France has engaged in a vigorous debate about corporate governance over the past decade. Michel Albert, former managing director of the French National Planning Office (1992), lays the foundation for the French debate by arguing that any system of corporate control is tied to social values. According to Albert, France has basically to choose between the Rhine Model (Germany) and America's freewheeling liberal system. He concludes, not unsurprisingly, that France's social and economic system is better suited to the German model. Implementing the German system in France would require few structural or attitudinal changes (Brean et al., 2003).

Corporate governance in France has often been described as an uncomfortable mixture of the American and German models (Brean et al., 2003). Company presidents (président directeur-générale, PDG) have held near dictatorial control over their boards and companies, leading to justified criticism about the ineffectiveness of control mechanisms (Helderman, 2000).

The executive management of French companies can exist in two different forms. The first one, which is the most commonly used by the listed companies, is based on the dominant power of the "President Directeur General" (PDG) who is CEO and Chairman at the same time. The second is the option of a two-tier board, a system similar to that adopted in Germany (EkonomiHgskolan, 2004).

Several factors have combined to lead market players to become concerned about corporate governance. Principal among them are privatization, the increasing presence of foreign shareholders - American pension funds in particular - the emergence in France of the pension fund concept, the desire to modernize the Paris financial market and the publication of the Viénot Report (AFG-ASFFI).

2.4.3.1. The Viénot Report (I)

The French employers' association CNPF (Conseil National du Patronat Français) and the private business association AFEP (Association Française des Entreprises Privées) have entrusted a corporate governance committee to review the principal issues concerning the membership, powers and operation of the boards of directors of French listed companies, to review related problems and the various solutions proposed and to draw the conclusions detailed in the Viénot Report (Viénot Report I, 1995).

The Viénot Report has attracted wide attention and was commented on in the press at large. However, the report did not propose substantial changes in present practices and the implementation of its recommendations has lagged. There has been no official follow-up in terms of a compliance report.

The Viénot Report acknowledged as an essential part of the French system, the principle that,

> whatever a board's membership and procedures may be, its members collectively represent all shareholders and it must at all times put the company's interests first" (Viénot Report, 1995: p.4).

The report affirmed that a board controlled by a majority shareholder,

> must be particularly attentive to avoid any conflict of interest, take all interests into due account and ensure the transparency of information provided to the market" (Viénot Report, 1995: p.14).

The committee report stated that

> implementation of its recommendations is necessary to consolidate investor confidence in the bodies governing the companies they are asked to invest in" ((Viénot Report, 1995: p.3).

Without such an implementation of fairly basic recommendations, French corporations cannot expect to maintain investor confidence.

The main recommendations of the Viénot Report (Viénot Report, 1995) are as follows.

- Boards should participate in decisions of strategic importance to a company.
- Each board should have a minimum of two independent directors.
- Cross-shareholding should be eliminated as quickly as possible.
- Companies should "avoid including an excessive number" of reciprocal directors on boards, and reciprocal directors should not serve on each other's audit or compensation committees.
- Each board should have a nomination committee that includes at least one independent director and the company chairman.
- Firms should disclose annually how it is organized to make decisions.

- Each board should have audit, compensation and nomination committees, and should indicate annually how many meetings the committees had. Each committee should be composed of at least three directors, one of whom should be independent. Neither executives nor employee directors should serve on the audit and compensation committees.
- Directors should "own a fairly significant" number of their company's shares.
- Executive directors should join no more than five boards other than their own.

However, compliance with the Viénot Report is entirely voluntary, and there is no requirement by the stock exchange or any regulatory body to disclose whether or to what extent a company adopts Viénot principles.

2.4.3.2. The Viénot Report (II)

The second Viénot Report was issued in 1999 by the Mouvement des Entreprises de France (MEDEF) [formerly CNPF] and the Association Française des Entreprises Privées (AFEP) (Viénot Report, 1999). The Report recommends that boards of public companies that have a single-tier board structure should be allowed to separate the post of *président du conseil d'administration* into separate chairman and CEO positions (Gregory, 2001). Gregory (2001) concluded that the Report also calls for expanded disclosure to shareholders as to:

- executive remuneration policy.
- stock options schemes.
- the total amount of directors' remuneration.
- individual directors' remuneration for attendance at board meetings.

2.4.3.3. The Marini Report

At the instigation of Prime Minister, Alain Juppé, Senator Philippe Marini in July 1996 issued a parliamentary report proposing sweeping reforms in French corporate law. The report came one year after the Viénot Committee concluded that no major legislative changes were needed. Marini's policy paper contained proposals addressing corporate governance matters, including measures to place various Viénot recommendations into law. The main recommendations of the Marini Report (Marini Report , 1996) are as follows.

- Boards should be permitted in law to name committees with autonomous powers.
- Companies should have the legal right, but not obligation, to separate the offices of chairman of the board and chief executive officer without having to adopt a two-tier board structure.
- Corporations should have to release detailed lists of its owners to all investors.
- Notices of meetings should be issued one month, rather than 15 days, before shareholder meetings.
- Shareholders who prefer not to vote themselves should be able to assign their voting rights to an independent entity rather than to management.
- Directors would be permitted to serve on no more than five boards.

2.4.3.4. AFG-ASFFI

France's fund management association, the Association Française de la Gestion Financière (AFG-ASFFI) adopted a report in 1998 (up-dated in October 2001) with best practice recommendations that go further than the Viénot Report I (1995) and the Marini Report (1996) and propose even tougher steps, such as stricter standards of independence for directors, greater disclosure, and an end of poison pill-style takeover defences (see AFG-ASFFI).

2.4.3.5. The Bouton Report

In April 2002, Bertrand Collomb, Chairman of the Association Française des Entreprises Privées et Association des Grandes Entreprises Françaises (association of French private-sector companies and association of major French corporations) (AFEP-AGREF), and Ernest-Antoine Seillière, Chairman of MEDEF (Mouvement des Entreprises de France), requested a working group chaired by Daniel Bouton, President of Société Générale Bank in France, to re examine the application in France of corporate governance principles (Bouton Report, 2002).

According to the Bouton Report (2002), the working group that was set up was charged with examining the following:

- improving the workings of company bodies for management or the supervision of management, in particular the audit committee;
- the adequacy of accounting standards and practices;
- the quality of financial information and communication;
- the effectiveness of internal and external controls (by auditors and regulators);
- relations between companies and the various categories of shareholders; and
- the role and independence of various other market players, such as banks, financial analysts, rating agencies, etc.

2.4.4. Germany

From the prosperity of the empire during the Wilhelmine Era (1890-1914), Germany plunged into World War I (1914-1918) followed by the Great Inflation of the early 1920s. Then, after a brief period of prosperity during the mid -1920s, came the Great Depression, which destroyed what remained of the German middle class and paved the way for the dictatorship of Adolf Hitler (1933-45) and World War II (1939-1945) (Kaes, 1994; and Allen, 2002).

The first several years after World War II were years of bitter penury for the Germans. Their land, their homes, and their property lay in ruin. As Germany's post-war economic and political leaders shaped their plans for the future German economy, they saw in ruin a new beginning, an opportunity to position Germany on a new and totally different path (Kaes et al., 1994).

Later, in the 1990s, economic forecasters have been projecting a longer lasting recovery in Germany, sparked off by strong export growth. Up to now, however, so-called external shocks impede an acceleration of growth. This leads to a pattern of very short and flat economic waves (Directorate General for Economic and Financial Affairs, 2002).

Corporate governance has become a highly charged issue in Germany after years of wars, inflations and depressions. After wide-ranging talks with the parties concerned and with academics, the German government has recommended a package of changes for the reform of corporate governance (Seibert, 2002).

The debate about corporate governance has become more important after the collapse of some major German firms such as Flowtex, Comroad and Philipp Holzmann International GmbH (Germany's biggest construction company employing 17,000) in 1999 (Transparency International, 2001), but that alone was not adequate ground.

Rather, the inflexible structure of shareholdings is gradually falling away and the shareholder structure is becoming more international, the influence of foreign institutional investors and their expectations are growing, a better stock market culture is developing, the investment behaviour is changing, the return on German share investment is becoming more attractive and financial intermediaries are reacting to these changes. For the legal and political framework, this means that against a background of institutional competition, there is growing pressure for changes and adaptation of some German company laws, stock market laws and accounting laws (Seibert, 2002).

German corporate governance principles maintain the old suspicions to a significant degree. Both the Stock Corporation Act (Aktiengesetz or AktG), the principle statute governing German corporations, and the statutory accounting principals set out in the Commercial Code (Handelsgesetzbuch or HGB) reflect a concern for protecting the interests of shareholders of a corporation (Aktiengesellschaft or AG) against those of directors and officers (Hutter et al., 2002). An AG must, for example, build up hidden reserves, segregated from its distributable retained earnings, as an additional "equity cushion" helping to ensure that the company can satisfy its creditors (Hutter et al., 2002). Nevertheless, the corporate governance regime of Germany has undergone significant changes during the past years (Seibert, 2002).

In Germany, effective regulations on corporate governance have been missing until now (Waclawczyk, 2002). In most of the other countries with a free market economy, a code of conduct with generally accepted principles is already in existence. These principles enable investors to check and to judge systematically a corporation in regard to its corporate governance (Waclawczyk, 2002).

As a result, rapid change pertaining to corporate governance now figures as a global economic fact of life in Germany. In recent years, the downturn in the financial markets as well as a number of corporate scandals have spurred efforts by legislators, regulators and stock exchanges to improve corporate governance standards in companies whose shares are publicly traded (Hutter et al., 2002).

German corporate governance principles have a different origin from those of the US, England and other common law jurisdictions. Recent years have seen a measure of convergence between German and Anglo-American principles of corporate governance, as borders between capital markets have grown increasingly porous (Hutter et al., 2002).

The G8[4] nations are seeking the International Monetary Fund (IMF) and the World Bank to assess the extent to which countries are embracing their corporate governance standards and practices. They view new and improved governance practices as a key to spurring prosperity and jobs by strengthening corporations' abilities to compete for global capital (Davis, 1999).

In Germany, the legislature, regulatory bodies and securities exchanges have clearly made significant progress in modernizing corporate governance. Just as clearly, there remains room for additional improvement. More pressing, perhaps, than a need to simplify the mechanics of effecting board resolutions or obtaining shareholder consents is the need to further increase corporate transparency. Potential investors considering a purchase of shares and existing shareholders considering their votes at a shareholder meeting require adequate and accurate information. It may be expected, therefore, that the focus of future corporate governance reform in Germany will be the establishment of more demanding disclosure duties, backed up with credible deterrents for directors and

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[4] Canada, France, Germany, Italy, Japan, Russia, UK and USA

officers who knowingly or recklessly disseminate false or inadequate information (Hutter et al., 2002).

2.4.4.1. Control and Transparency in Business (KonTraG)

Due to both the internal pressure of mismanagement in German public companies and the external change caused by the globalisation of capital markets, the corporate governance discussions in Germany have resulted in much effort to create a system of regulations to make Germany more attractive to local and international investors. In addition to this, the regulations are intended to stem the criticism of numerous aspects of German corporate governance, such as poor alignment with shareholders' interests, the lack of transparency within German management and poor co-operation between the management and board of directors (Waclawczyk, 2002).

A wide discussion also resulted, relating to the effects of the introduction of the Euro[5] on shares with nominal value. Proposals have been submitted to Parliament. Recently, the German government had approved the law on control and transparency in business (KonTraG). The law was approved in March 1998 by the Bundestag, parliament's lower house (Ferrarini, 2000).

A summary of the regulations in the KonTraG is as follows (Ferrarini, 2000).

- Repurchase of a company's own shares will be allowed under strict conditions (previously forbidden).
- Shares with multiple voting rights would not be further allowed.
- There would not be a mandatory reduction in the number of members of the supervisory board, while members may continue to sit on ten boards.
- Minority claims against directors would be made more accessible, by reducing the threshold to 5 percent. (Previously 10 percent).
- The supervisory board, not the management board, will appoint auditors.
- The influence of the banks is somewhat curbed: banks may not vote as proxy holders if voting in their own name for more than 5 percent of the shares.

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[5] On January 4, 1999 the Euro was successfully implemented in a big-bang approach in the German security market.

2.4.4.2. German Code of Corporate Governance (GCCG)

In January 2000, a German panel of governance scholars, shareholder activists and corporate executives issued a set of corporate governance guidelines referring to the OECD Principles and encouraging companies to be more transparent on governance and compensation (Gregory, 2001).

The Berlin Initiative Group, comprising academics and professionals, on 6th June 2000, issued the German Code of Corporate Governance (GCCG). It highlights the standards of good management and supervision for companies which develop their value creating activities in and from Germany and contains recommendations for the arrangement of the regulatory framework for managing and supervising a company. The Code, which is directed primarily towards large, listed public stock corporations, is not only intended to promote the quality of company management, but at the same time also serves as a source of information for foreign investors seeking a compact introduction into the basic principles of corporate governance in Germany (Tüngler, 2000).

The GCCG is not intended to provide suggestions for reform, but rather suggestions which complement and describe the existing law. The reason for this concentration on existing law is the consideration that improvement can be brought about within the framework of the GCCG (GCCG, 2000).

The GCCG suggests that each company take the recommendations of the report and have a checklist in its annual report that states which guidelines were adopted and which were not and the reasons for that (GCCG, 2000).

2.4.4.3. DSW Guidelines

The Deutsche Schutzvereinigung Für Wertpapierbesitz (DSW), Germany's largest shareholder organization, has successfully worked towards the adoption of legislative changes to German corporate law that should promote positive corporate governance principles through the new Control and Transparency Law.

Furthermore the Deutsche Schutzvereinigung Für Wertpapierbesitz had the following proposals to be followed by German companies as a minimum benchmark for good corporate governance (DSW).

- Prohibiting supervisory board members from simultaneously sitting on a competitor's board.
- Prohibiting conflicts of interest among supervisory board members.
- Eliminating interlocking ownership.
- Ensuring the independence of the corporate auditor.
- Requiring greater accountability and transparency on banks that vote their beneficial shares through greater proxy voting disclosure on the part of German banks including providing public notice when voting against management.
- Providing more advanced notice of Annual General Shareholders meeting.
- Proxy voting to be simplified

2.4.4.4. Corporate Governance Rules for German Quoted Companies

The Code of Best Practice for German Corporate Governance was drawn up by the Frankfurt Panel on Corporate Governance in July 2000. The Rules of the Code of the German Panel on Corporate Governance serve as general guidelines for Corporate Governance of quoted German companies. Quoted companies are all enterprises whose shares are officially listed on a German stock exchange or traded over-the-counter. The Rules and respective adjustments to the specifics of the individual company shall be published on the Internet. In addition, their acceptance and implementation shall be communicated in the Annual Report (German Panel on Corporate Governance, 2000).

2.4.4.5. Baums Commission Report 2001

The German government appointed a government commission to draw up proposals for making German corporate governance more transparent for both domestic and foreign investors and for strengthening confidence in the management of German corporations (Baums Commission Report, 2001). The recommendations of the Baums Commission have been the impetus for much of Germany's recent efforts to reform corporate governance.

2.4.4.6. Cromme Code 2002

The Baums Commission urged in one of its recommendations that the government convene a group of experts to create a new Corporate Governance Code (Cromme Code, 2002). Acting on this, the government appointed an expert panel led by Gerhard Cromme, chairman of the Supervisory Board of ThyssenKrupp AG. The Cromme Commission promulgated the Corporate Governance Code in February 2002. The Code sets out practical standards of conduct for members of management and supervisory boards, determines duties of reporting and disclosure to shareholders and defines the role of auditors (Hutter et al., 2002).

Following the release of the Code, the Cromme Commission has been mandated as a standing commission to review continuously and modify and update the Code as appropriate.

The German legislature implemented further proposals of the Baums Commission by enacting the Transparency and Publicity Act in July 2002. This Act strengthens the supervisory boards of AGs and provides a legal framework for the Corporate Governance Code.

2.4.5. Korea

In 1996, Korea became the 29th member country of the OECD, which was created with the objectives of plural democracy, free market economy and the respect of human rights and which has since played a leading role in shaping new international standards and norms in the social and economic areas, such as macroeconomic policy, trade, environment, competition policy, energy, consumer protection and education (Korean Ministry of Legislation, 2003).

A balanced analysis of corporate governance practices of Korean companies requires an understanding of Korea's legal system, Commercial Act, as well as its Code of Best Practice.

Beginning in the 1960s, Korea has enacted various Acts and subordinate statutes focused on the administrative and economic areas to support the government-led economic growth policy in the course of the nation's rapid modernization. In pursuing high economic growth, Korea temporarily maintained the authoritarian government restricting the people's fundamental rights. In the late 1980s, however, Korea pushed ahead with democratisation in the political area and, in the economic area, Korea started revamping the legal system with the aim of curtailing the role of government and restoring the market economy (Korean Ministry of Legislation, 2003).

2.4.5.1. Legal Systems

In Korea, the laws most directly affecting corporate governance are the corporate laws found in the Commercial Code; in the Joint Stock Companies Law; the Securities and Exchange Act; the Act on External Audit of Joint Stock Companies and the Bankruptcy Law, etc (Gregory, 2001; Bae et al., 2002; and Campbell et al., 2002).

The Korean government authorities had assigned the Financial Supervisory Commission (FSC), which was established in 1998, to be the engine of the structural reform of the financial markets. As the next step, the Financial Supervisory Service (FSS) was formed in 1999, by consolidating four separate supervisory agencies, namely, Banking Supervisory Authority, Securities Supervisory Board, Insurance Supervisory Board, and Non-bank Supervisory Board. The role of FSS was to supervise and regulate the activities of financial service providers and other participants in the financial markets. Both FSC and FSS carried out the task of providing financial companies with prudential regulation, and applied Forward Looking Criteria (FLC) (Kishi et al., 2001).

2.4.5.2. Commercial Act

The Commercial Act (1962) is a law that regulates the existence and the relationships of the enterprises that have the purpose of profit-making. It is composed of five parts which are the General Provisions, Commercial Activities, Companies, Insurance and Maritime Commerce (Korean Commercial Act, 1962).

According to the law, companies are grouped into four categories: partnership companies, limited partnership companies, stock companies and limited liability companies (Korean Commercial Act, 1962).

2.4.5.2.1. Chaebols

The Korean government's Heavy and Chemical Industries (HCI) drive in the 1970s set the stage for the emergence of large conglomerates, known as chaebols in Korea, which has been the engine of growth since then. A chaebol is characterized as a group of large corporations operating in diverse and mostly unrelated industries, usually under the ownership and control of a single family. Many scholars agree that the success of chaebol has highly depended upon the strong support of the State, coordinating investment and export strategies and constraining the labor force. The chaebol was implemented through subsidized credit, special tax policies, selective protection, entry restrictions and direct government involvement in industrial decision-making (Cheng, 1990; Fields, 1995; Haggard and Moon, 1993; Kim, 1997; Seong, 1997; Wade, 1990; and Woo, 1991).

The term chaebol, which means 'financial house', is commonly used to refer to conglomerates consisting of many related companies, including a number of companies listed on the stock exchange, which are engaged in a broad range of industrial and service businesses (Black, 2001). The chaebol structure enables Korea to start industries that required huge initial investment and risk sharing such as heavy machinery, automobiles, shipbuilding, and microchips. Such large investment was not feasible for companies in other comparable developing countries like Taiwan, Indonesia, Hong Kong, etc. (Koo 1998, Kim 1997).

In 1995, the 30 largest chaebols represented 41 per cent of total sales in the Korean domestic economy, 40 per cent of value added, 44 per cent of total fixed assets and 18 per cent of employment. The five[6] largest chaebols represented 26 per cent of total domestic sales, 27 per cent of total value added, 26 per cent of total fixed assets and 11 per cent of total employment (Seong, 1997; Wade, 1990).

[6] Hyundai, Daewoo, Samsung, LG (Lucky Goldstar) and SK (Sun kyong)

However, chaebols were not always profitable and occasionally faced financial distress. During these occasions, the government repeatedly intervened. During the debt crisis of 1972, the government froze their debts and gave them bail-out loans (Cho, 2003). Between 1979-1983, firms in the heavy and chemical industries[7] suffered from over-investment and from the depression following the second oil shock (Economic Planning Board, 1994). To deal with insolvency problems associated with excess capacity, the government gave financial subsidies and consolidated firms to create more concentrated markets. In the 1980s, the government adopted some liberal pro-competition policies, privatizing commercial banks during 1981-83, and reducing the gap in interest rates between industrial policy loans and general loans. During 1984-1988, many debt-ridden firms became insolvent, only to have the government intervene yet again[8] (Cho, 2003). By providing the creditor banks with special 3% to 6% interest rate loans (the general bank loan rate was about 12%.) (Lee 1998; Kim 1999), the government allowed them to write off bad debts, extend debt maturities, and replace existing debt with longer-term debt at a lower rate (Cho, 2003; Kim, 1997). In short, the government had repeatedly given large firms preferential subsidies and bailed them out during times of financial distress.

2.4.5.4. Corporate Governance and Reforms

In Korea, corporate governance did not begin in earnest until 1996, and was largely prompted by the financial crisis of 1997-1998 (Shim, 2002). During the Asian financial crisis in 1997, the chaebols were characterized by low transparency of corporate decision-making, low accountability of senior managers and higher debt-equity ratios than their principal international competitors (Joh, 1999). The Asian financial crisis overtook the Korean economy in 1997. The crisis in Korea had many causes, though it was triggered by a number of large-scale corporate failures, beginning with the failure of Hanbo Steel, the 14th largest chaebol, in 1997. Another steel producer, the Samni group, followed suit. Then came Jinro's turn, the 19th largest chaebol, and the Sangyong business group, the

[7] These industries include power generating equipment, cars, engines, heavy electric equipment, telephone switching systems, refined copper, etc.,

[8] The government revised its tax exemption law to facilitate the insolvency procedure in December 1985.

6th largest (Allayannis, 2003). Corporate failures placed financial institutions at risk and led to a collapse of international confidence in the economy and the withdrawal of foreign investors and financiers from the Korean markets. As a result, major reform is now in progress.

Since the financial crisis in Korea there have been numerous changes in corporate governance in both the private and public sectors. A principal focus of the government's policy response to the crisis was to reform Korea's corporate governance standards. The government undertook a series of measures to force the chaebols to focus their business operations on a small number of core businesses in each group, rely less on debt financing, improve transparency in corporate decision-making, and enhance the accountability of controlling shareholders and managers (Black et al., 2001; Koo, 1998; Nam et al., 1999; Joh, 2001; Kim, 1999; and Shim, 2002).

In 2000, the Korean authorities initiated a series of improvement measures for corporate governance, with the introduction of an outside directorship system and protection of minority shareholder interests as the principal features. In order to protect their interests, minority shareholders have fortified their rights to demand cumulative voting (Kishi et al., 2001). The system of appointing outside directors to company boards was aimed at improving the monitoring capabilities. For example, large companies that were listed on the Korea Stock Exchange (KSE) were required to nominate at least three outside directors to their boards, and an audit committee had to be set up with outside directors comprising at least two-thirds of the standing membership.

In order to promote more precise disclosure and to boost monitoring capabilities, FSC and FSS have introduced a "Regulation on External Auditing and Accounting", and the use of consolidated balance sheets in financial accounting. In addition, FSS introduced the Continuous Credit-Risk Assessment System (CCRAS), so that banks could be inspected on a regular basis using the authority and esteem, as well as the technical standards, of CCRAS (Koo, 1998).

Shareholdings by institutional investors in Korean companies are low compared to other developed countries and many institutional investors are affiliated with and controlled by the chaebol. Foreign institutional investors have recently become significant investors in Korean firms, but thus far have had very modest influence on Korean corporate governance. Foreign investors' share in the Korean stock market represented 36% of market value, as of February 2002. Therefore, Korean firms and institutional investors have been increasingly pressed to reinforce and activate stronger corporate governance measures (Nam, 1999; and Shim 2002).

In short, the following are some of the post-crisis amendments to the principal Korean legislation and regulations relating to corporate governance (Black et al., 2001; Koo, 1998; Nam et al., 1999; Nam et al., 2001; Joh, 2001; Kim, 1999; Shim, 2002; and Mitton, 2001).

- The Securities and Exchange Act was amended to require that boards of directors must be independent. For those with assets greater than 2 trillion Won, at least 50 per cent of the board's members must be independent.
- The regulation on Securities Listing granted to the Korea Stock Exchange enhanced its powers to ensure the independence of listed companies' external auditors.
- To enhance transparency, the government has introduced significant changes in financial accounting standards (December 1998) to bring them into conformity with International Accounting Standards (IAS) or United States Generally Accepted Accounting Principles (GAAP).
- Given that the financial crisis highlighted the deficiencies in the disclosure system of the securities market, the government improved disclosure systems by legislating for quarterly reports in addition to the annual and semi-annual reports previously required, electronic filing systems, allowing more class action lawsuits, and meting out more severe penalties in the case of violations (Nam et al. 2001).
- In regard to a direct corporate governance system, the government obliged publicly traded companies to elect outside directors in 1998.
- An explicit fiduciary duty has been established, requiring directors to "perform their duties faithfully for the good of the company" in accordance with applicable law and the company's articles of incorporation.

- Shareholders may propose matters for consideration at a general shareholder meeting.
- The minimum shareholding level required for shareholders to assert rights has been reduced for: (i) demanding removal of directors and auditors for wrong-doing; (ii) seeking an injunction against a director who violates applicable law or a company's articles of incorporation; (iii) initiating a derivative lawsuit; (iv) convening a general shareholder meeting; (v) inspecting a company's account books; (vi) applying to court for appointment of an inspector to investigate the company's actions; and (vii) demanding the removal of a liquidator. These levels were further reduced for listed companies and yet further reduced for the largest listed companies (with paid-in capital of not less than 100 billion Won) (Black et al 2001).
- Many large publicly owned companies started to improve their governance systems after they were mandated to do so by the government.
- In 1999, the government introduced an audit committee and other committees in the board.
- In 1999, the Code of Best Practices was announced (which was framed by a corporate governance committee composed of various professionals).
- The Korea Stock Exchange (KSE) in 2001 announced its own survey regarding the improvement of corporate governance of listed companies.

2.4.5.4. Codes of Best Practices

According to both the 1999 Korn/Ferry survey and the KSE survey (1999), Korean corporate governance still lagged far behind international standards (Korn and Ferry, 1999). Two more recent surveys, one from Standard and Poor (S&P) and the other from Credit Lyonnaise Securities Asia (CLSA), further confirm the low degree of corporate governance in Korea, while pointing out the positive relationship between corporate governance and return on equity (CLSA, 2001; and S&P, 2001).

In March 1999, the Ministry of Finance and Economy initiated the creation of a Private Sector Committee on Improving Corporate Governance, as a non-government body, to develop a code of best practice. In September 1999, the

Committee adopted the *Code of Best Practices for Corporate Governance* (the "Best Practices Code").

According to the *Code of Best Practice for Corporate Governance* (1999), the purpose of the Code is to maximize corporate value by enhancing the transparency and efficiency of corporations for the future. This Code applies to listed companies and other public companies. The contents of the Code consist of five sections and recommendations: Preamble, Shareholders, Board of Directors, Audit Systems, Stakeholders and Management Monitoring by the Market.

2.4.5.4.1. Shareholders

- Shareholder rights shall be protected; they must be able to exercise their rights through proper procedures and be treated equitably under the principle of shareholder equality.
- Controlling shareholders have the corresponding responsibilities when they exercise any influence towards the corporate management other than the exercise of voting rights.

2.4.5.4.2. Board of Directors

- The Board of Directors shall make the key management policy decisions, supervise the activities of directors and management, observe the related statutes and the articles of incorporation when performing its duties and ensure that all members of the corporation also observe them.
- The directors and the Board shall perform their duties faithfully in the best interests of the corporation and its shareholders; they shall also perform their social responsibilities and consider the interests of various stakeholders.

2.4.5.4.3. Audit Systems

- Audits shall be performed by those independent from stakeholders in the corporation, such as the management or controlling shareholder, and by those who specialize in auditing.

- Auditors shall audit with sufficient information provided and shall invest much time and effort, and they shall not reveal, unless required by law, any confidential corporate information learned while auditing.

2.4.5.4.4. Stakeholders

- The rights and authority of interested parties according to the law and contract shall be protected.
- Participation of interested parties in corporate governance shall be determined autonomously, considering the level of interests of the parties and the rights protection systems.
- Corporations and interested parties shall cooperate for mutual benefit.

2.4.5.4.5. Management Monitoring by the Market

- Formation and function of related markets shall be protected so that corporate takeovers may be used as a means to raise efficiency of corporate management, thereby further increasing corporate value.
- Corporations shall actively disclose matters of material importance to the decision-making of shareholders, creditors and other interested parties.
- Corporations, to become equipped with a sound governance structure, shall actively disclose their governance so that interested parties such as shareholders may evaluate them.

2.4.6. Malaysia

The economic turmoil faced by so many countries, including Malaysia, that started in July 1997, to a certain extent, was caused by a lack of proper corporate governance in the corporate sector (Haji Ali, 1999). So, all relevant regulatory authorities in Malaysia must cooperate and give their fullest and sincere assistance and full support to the corporate sector for continuing economic recovery.

A proper and efficient system of corporate governance should be able to regulate and monitor companies. It should also be able to ensure that company directors act in the best interests of their companies as well as ensuring the observance and compliance with all laws, regulations and codes of conduct and best practices (Keong, 2002).

Companies need effective and friendly guidance from the relevant regulatory authorities for their growth and good corporate governance (Keong, 2003), especially in 'bad times' as Malaysia faced in 1997. Setting standards and creating a culture of good governance is the collective responsibility of regulators, advisors of publicly listed companies and the board of directors and senior management governing the respective companies (Charkham 1995).

2.4.6.1. Regulatory Authorities

In Malaysia, companies are guided by a number of laws and regulations and non-legal requirements and codes of conduct (Anwar, 2003; Cheah, 2003; Haji Ali, 1999; Koh, 1999; KLSE, 2002; Rajenthran, 2002; and Koh, 1994). Principal among them is the Companies Act 1965, a law regulating companies which was based originally on the U.K. Companies Act 1948 and the Australian Uniform Companies Act 1961 (see Companies Act 1965). The Act sets out requirements for the birth, death and existence of companies. It identifies fundamental rules governing procedures for incorporation, the basic constitutional structure and the cessation of existence of companies. The Act imposes minimum requirements on the way in which corporations are incorporated consistent with the Malaysian contractualist system of company law where the control structure is left to be determined by the promoters and the company through the Memorandum and Articles of Association of a company (Companies Act 1965).

The Companies Act has been amended twenty-seven times since it was first implemented on 15 April 1966 to take into account the various comments and suggestions from the private and corporate sectors. The amendments have also taken into account abuses of company structures by company directors.

In addition to the Companies Act 1965, publicly listed companies must also observe and comply with the Securities Commission Act 1993, the Securities Industry Act 1983, the Policies and Guidelines On Issue/Offer of Securities issued by the Securities Commission (SC) and the Listing Requirements of the Kuala

Lumpur Stock Exchange (KLSE). The Companies Commission of Malaysia Act 2001 (the Act) also came into operation on 16 April 2002. This Act establishes the Companies Commission of Malaysia, provides for its function and powers and for matters connected therewith (Anwar, 2003; Cheah, 2003; Haji Ali, 1999; Koh, 1999; KLSE, 2002; and Rajenthran, 2002).

The guidelines of the SC set out the requirements which have to be met before embarking a corporate proposal as well as the continuing obligations with which all parties concerned must comply once their proposals have been approved by the SC (Haji Ali, 1999). The KLSE listing requirements, in addition to other matters, contain a requirement for every listed company to set up an audit committee as a sub-committee of the board of directors. The prime role of an audit committee is to provide an independent evaluation of a company's financial reporting function. It involves both financial reporting to the shareholders and others as well as a company's business ethics. The audit committee must comprise not less than three members with a majority of them non-executive independent directors who are not related to the executive directors of the company or its related corporations and chaired by a non-executive director (KLSE, 2001).

One of the essential issues with the whole corporate governance exercise is its credibility. Thus, regulators and rules do play an essential role for enforcement. In terms of promoting effective enforcement, transgressions must be penalized and rules must be effectively enforced.

Under Malaysian law, shareholders have a proprietary right to vote, with one vote per share. Shareholders can register ownership to convey or transfer shares, participate and vote at general shareholder meetings and elect members of the board. Shareholders also may submit proposals to the general meeting. Finally, the Securities Commission is examining ways to allow shareholders cumulative voting rights (Rasiah et al., 2000).

2.4.6.2. Stock Exchanges

There are currently two stock exchanges and one futures exchange in Malaysia, which are the Kuala Lumpur Stock Exchange (KLSE), the Malaysian

Exchange of Securities Dealing and Automated Quotation Bhd (MESDAQ) and the Malaysia Derivatives Exchange (MDEX). As at 6 August 2003, 886 companies were listed on the KLSE and the MESDAQ. Of these, 571 companies were listed on the main board, 291 were listed on the second board and 24 companies were listed in the MESDAQ market (KLSE, 2002; and Seong, 2003).

The KLSE is a public company limited by guarantee incorporated in 1976 under the *Companies Act 1965*. It has no shareholders and no share capital, only members, with membership comprising two classes—voting and non-voting, as defined in Article 1 of the KLSE's *Articles of Association*. Voting members are made up of companies that carry on the business of dealing in securities, which are stock-broking companies. Non-voting members may either be dealing members or non-dealing members. Dealing members refer to executive directors of the member companies, who hold a dealer's representative licence, while non-dealing members include individual and corporate shareholders, and non-executive directors of the member companies (Seong, 2003).

In January 2001, the Kuala Lumpur Stock Exchange became the region's first to require disclosure of compliance with the Corporate Governance Code via its listing requirements, enhancing the protection of minority shareholders (KLSE, 2002). Listing requirements are amongst the best in East Asia, and similar to London Stock Exchange rules. For example, all listed companies must report on corporate governance in their annual reports. Company directors also must report separately on internal control in the annual report (KLSE, 2001).

The MESDAQ Market was created on March 18, 2002 following the merger between the MESDAQ and the KLSE. It operates as a unique market with a separate identity from the KLSE Main and Second Boards, catering specifically for the capital raising needs of technology and high-growth potential companies. The framework of the establishment of the MESDAQ Market was first unveiled by the Securities Commission (SC) in February 1997. With more of the growth and development of the economy being premised upon higher value-added activities, the SC recognised the need for an equity market to fund the development of technology-based, high-growth companies (Abdul Kadir, 2001).

The Malaysia Derivatives Exchange Berhad (MDEX) began operations on 11 June 2001. The MDEX operates under the supervision of the Securities Commission and is governed by the Futures Industry Act (FIA) 1993. The Exchange also falls under the jurisdiction of the Ministry of Finance of Malaysia (MIDA, 2004).

2.4.6.3. Corporate Governance

The Malaysian regulatory authorities: Registrar of Companies (ROC); Securities Commission (SC); Kuala Lumpur Stock Exchage (KLSE); Bank Negara;Foreign Investment Committee (FIC); and Ministry of Finance (MOF), each has its role to play in assisting companies to achieve good corporate governance.

Legal infrastructure such as rules and regulations must be in place to facilitate corporate development from time to time. New rules must be enacted and obsolete ones amended accordingly. In order to keep in tandem with latest developments in the corporate sector, rules and regulations must take into consideration the numerous comments and suggestions from the various associations representing the private and corporate sector (Cheah, 2003; Haji, 1999; Koh, 1999; and KLSE, 2002). For that matter, the Companies Act 1965 had been reviewed and amended since its inception. These amendments are necessary in order to facilitate corporate growth and thus establish a framework for good corporate governance. On the other hand, having a good piece of law alone does not guarantee effective implementation, unless the regulatory authorities concerned take the necessary steps to enforce them effectively.

Thus, in 1997, the Malaysian government made a pledge that Malaysia would take a leading role in corporate governance in the Asian Pacific Region (MIDA, 2004). The Malaysian government placed emphasis on establishing good corporate governance practices carried out by the private sector as well as the government (Koh, 1999). The government established a High Level Committee on Corporate Governance including senior officials of the relevant government agencies and representatives of the private sector.

In March 1998, the Malaysian Code on Corporate Governance (the Malaysian Code), another milestone in creating good corporate governance, was created when the Registrar of Companies formed an entity known as the Malaysian Institute of Corporate Governance (MICG). The objective for setting up this body was to represent, express and give effect to opinions of members of MICG on issues relating to corporate governance in Malaysia, promote and encourage corporate governance development and educate the public and corporations on the importance of good governance to enhance shareholder's value and bring about corporate prosperity (Seong, 2003).

Both the Securities Commission (SC) and the Kuala Lumpur Stock Exchange (KLSE) played crucial roles in enhancing corporate governance in Malaysia. KLSE makes amendments to the Listing requirements that were implemented by the Exchange on a continuing base. The key objectives of revamping the old listing rules are to enhance corporate governance and transparency, enhance efficiency in capital market activities, strengthen investor protection and promote investor confidence. In line with these objectives, the following points were incorporated in the new listing rules that will be adopted by KLSE: (i) strengthening provisions in areas relating to disclosure, corporate governance, continuing listing obligations, financial reporting and protection of minority shareholders; (ii) codifying unwritten rules and procedures relating to listed issuers; (iii) simplifying procedural requirements and processes; and (iv) clarifying requirements and removing ambiguities and adopting global trends and standards in listing rules, where applicable (KLSE, 2001).

The SC also initiated recommendations to the role of internal auditors. This requires all publicly listed companies to set up an internal audit function. Where there is no internal audit function, the Code provides that the audit committee should assess whether there are other means of ensuring that there is regular review and appraisal of the company's internal controls (Cheah, 2003).

2.4.6.4. Code of Best Practice

The Finance Committee report on corporate governance sets the Malaysian Code on Corporate Governance, which provides principles and best practices for good corporate governance.

According to Abdul Kadir (2001), Chairman of the Securities Commission, the recommendations of the Finance Committee are broadly focussed on the following three key areas.

- legal reform - to strengthen the statutory and regulatory framework for corporate governance;
- developing a Malaysian Code on Corporate Governance - to enhance the self-regulatory mechanisms that promote good governance; and
- training and education - to ensure that the proposed framework for corporate governance is supported by necessary human and institutional capital.

The significance of a Code for Malaysia is that it will require companies to make the relevant governance disclosures which then introduces more information about how boards function in Malaysia. Another fairly significant feature is the aspirational and evolutionary way in which a Code influences the expectations of society that are eventually reflected in the law. The attention generated by the Code of Best Practice has already had an impact on evolving judicial interpretations of director's duties. Certainly the Code also acts as a valuable guide to boards by clarifying their responsibilities and providing prescriptions strengthening the control exercised by boards over their companies.

In March 2000, the Malaysian Code on Corporate Governance was developed by a Working Group on Best Practices in Corporate Governance (JPK) and subsequently approved by the Finance Committee on Corporate Governance. The Code aims to set out principles and best practices on structures and processes that companies may use in their operations towards achieving the optimal governance framework.

The Code mainly focuses on public listed companies and identifies a set of guidelines or practices intended to assist public listed companies in designing their approach to corporate governance. While compliance with best practices is voluntary, companies will be required as a provision of the listing requirements of the KLSE to state in their annual reports the extent to which they have complied with the best practices. By adopting relevant key principles contained in the Code, the respective companies could enhance the standards of governance in their respective organisations.

2.4.6.5. Survey on Corporate Governance

KLSE and PwC conducted a benchmark survey in 1998 to assess the level of corporate governance in Malaysia. In 2002, the Kuala Lumpur Stock Exchange (KLSE) and PricewaterhouseCoopers (PwC) conducted a Corporate Governance Survey to gauge current perceptions among key stakeholder groups on Malaysian Corporate Governance (CG) Standards. It also reviewed CG practices in Malaysia in accordance with the various recommendations and guidelines prescribed in the Malaysian Code of Corporate Governance and the KLSE listing requirements (KLSE, 2002). In part, the Corporate Governance Survey 2002 is a follow-up to the 1998 benchmark survey on the level of corporate governance in Malaysia in view of recent developments.

Results from the survey already highlight the positive developments in Corporate Malaysia, with regards to corporate governance practices. The main results are:

- Malaysia's Corporate Governance standards are perceived to have improved since the 1998 Survey, with the introduction of the Malaysian Code on Corporate Governance and the new KLSE Listing Requirements;
- Malaysian public listed companies (PLCs) are highly cognisant of the need for Board independence and most adopt a clear division of responsibilities between the head of the Board (Chairman) and the chief executive charged with the running of the company's business (CEO / MD);

- Institutional Groups are willing to pay at least 10% premium for shares in organisations that have excellent Corporate Governance practices;
- Institutional Groups indicate the strong influence of non-financial information in their investment decisions;
- Malaysian PLCs now recognise that shareholders' and investors' communication play a significant part in enhancing the confidence of investors who now demand greater transparency and disclosure of capital markets; and
- the on-going local and global regulatory and co-regulatory progress on CG have made directors as a group more aware of their greater fiduciary duties and responsibilities.

In short, Malaysia was well advanced in upgrading its corporate regulatory environment when the crisis hit. In the 1980s, authorities required listed companies to appoint independent directors to their boards and establish audit committees. In 1996, Malaysia committed to move from a merit based to a disclosure based regulatory regime for listed companies. Since the crisis, key reforms include incorporating the Code of Corporate Governance into listing rules and improving overall compliance (KLSE, 2001).

2.5. SUMMARY

Since mid 1990s the corporate governance movement grew into a major movement worldwide, spreading from the US, over the UK to the rest of the world (Carlsson, 2001; Keong, 2002; and Charkham, 1995). Despite the diversity in corporate governance between the United States, United Kingdom, France, Germany, Korea and Malaysia, it has been noticed in the discussion above that all of them are undertaking corporate governance reforms. This emphasizes the strong trend in changing law and regulations or/and setting best practices of corporate governance. The goal is to have strong and independent boards of directors, enhanced shareholder rights and activism, fuller financial disclosure, tighter control of insider trading and self-dealing transactions, greater accountability of controlling shareholders, directors and stronger regulatory environment.

It has also been seen that countries around the world are characterized by alternative corporate governance systems (Shleifer et al. 1997). Considerable debate is going on illustrating how good, superior or effective these systems are. Prowse (1995) suggests that such judgments are inherently subjective because of the sparse evidence on the relative performance of different corporate governance systems.

It has been shown in this chapter that corporate governance encompasses rules and market practices which determine how companies make decisions, the transparency of their decision-making processes, the accountability of their directors, managers and employees, the information they disclose to investors and the protection of minority shareholders. It involves issues of company law, securities laws, the listing rules of a country's stock exchanges, accounting standards applicable to listed companies, competition or anti-trust laws and bankruptcy or insolvency laws. It includes government regulations and regulatory agencies with which corporations and shareholders deal and those regulators' actions to ensure compliance with applicable laws and regulations. Corporate governance involves the courts as well, since shareholders, directors, managers and regulators call upon courts to resolve corporate governance disputes and enforce government regulations.

In short, corporate governance has become, and is likely to remain, a powerful tool for attracting foreign direct investment. In order to remain competitive in a changing world, corporations must adapt their corporate governance practices to meet new demands and benefit from new opportunities. Likewise, governments have an important responsibility for shaping an effective regulatory framework that provides for sufficient flexibility to allow markets to function effectively and to respond to expectations of shareholders and other stakeholders.

\CHAPTER THREE:

CORPORATE GOVERNANCE IN SAUDI ARABIA

3.1. INTRODUCTION

The development of corporate governance in Saudi Arabia is of interest for a number of reasons. First, Saudi Arabia presents a unique combination of size, stage of development of the economy and wealth, coupled with strictness of Islamic observance. Second, corporate governance in the Saudi context has received very little attention from researchers. Despite the richness of Islamic teachings on the conduct of business and trade, very little has been written on corporate governance in Islamic societies. In this thesis, four important elements of corporate governance will be explored in the case of Saudi Arabia, namely: shareholder rights, board of directors, audit committees and disclosure and transparency. Islamic law (Shari'ah) and Islamic jurisprudence (the Fiqh) are analyzed as a basis for the regulation of corporate governance.

Corporate governance of a particular country reflects its history, culture, regulatory structures and capital market characteristics (Keong, 2002). Therefore, when studying corporate governance in Saudi Arabia, it is obviously essential to consider the country's history, culture, regulatory structures, economic and capital market characteristics, etc. It is important to mention here that Saudi Arabia is in the foundation stage of developing corporate governance and no Code of best practices has been set up yet.

In the following section (section 3.2), a summary of the Saudi Arabian background will be presented highlighting the country's constitution, legislation and five-year development plans. In the next section (section 3.3), some important facts relating to the Saudi Arabian oil and non-oil economy will be raised. In section 3.4, it will be indicated that the Saudi Arabian corporate governance is governed by four bodies: the Ministry of Commerce, the Saudi Arabian Monetary Agency (SAMA), the Saudi Stock Exchange (Tadawul) and some professional bodies. In section 3.5, the author tries to assess corporate governance, specifically assessing four corporate governance mechanisms: shareholder rights; board of directors; audit committees; and disclosure and transparency, and to test the intensity of adoption of these mechanisms in the Saudi publicly traded (joint stock) corporations. In section 3.6, it will be explained how Islam effects corporate governance in Saudi. It will be shown that the development of corporate governance must be based on the provisions of Islamic Law (the *Shari`ah*) and Islamic Jurisprudence (the *Fiqh*) along with other necessary principles and postulates which are not in conflict with the shari`ah and fiqh. In the last section (3.7), there is a summary of the most important issues discussed in this chapter.

3.2. SAUDI BACKGROUND

The Saudi Arabian State was first established in the central region of the Arabian Peninsula in the early 18th century (Al-rasheed, 2002). Then, the modern Saudi Arabia was founded in 1932 by King Abdul Aziz Al-Saud. The nation experienced remarkable growth over a short period, spurred by the discovery of oil in the 1930s. This income has given the monarchy the ability to deliver benefits to all sectors of a populace grateful to receive them, to develop a very powerful centralized security force, and to increase Saudi Arabia's influence in regional affairs, thereby buffering some of the security problems it faces on several borders (Hudson, 1999).

Prior to the discovery of oil in the 1930s, the Saudi economy revolved around the pilgrimage to Makkah (Mecca) in the western area, subsistence farming in the few agricultural regions in southern and central regions, and pearling along the eastern coast. After the Second World War, oil quickly replaced these activities as the main source of revenue. In the early 1970s, the Kingdom embarked on a long-term program to use its substantial oil revenues to build the infrastructure for diversification of the economy into several areas besides oil. In the 1970s and 1980s, the government played the leading role in establishing basic infrastructure and institutions. From the early 1970s until the early 1980s the government invested heavily to modernize the country, building and owning the telecommunications, electric power, water, road, airline, rail, health care and education infrastructure and systems (Kingdom of Saudi Arabia, 1970, 1975, 1980, 1985, 1990, 1995 and 2000).

3.2.1. Saudi Constitution

On March 1, 1992, King Fahd Bin Abdul Aziz Al-Saud issued three major laws: the Basic Law of Government, the Consultative Council Law and the Law of Provinces. The Basic Law of Government formalizes several aspects of the constitutional framework of the country. The Consultative Council Law replaces the existing council, established in 1926, with a new council to be appointed by the king within six months. The Law of Provinces aims at regulating the relationship between central government agencies and regional governors, replacing a 1963 law that was never implemented.

Chapter I, Article 5 of the Basic Law of Saudi Arabia adopted in 1992 provides that the central institution of Saudi Arabian government is the monarchy headed by King Fahd Bin Abdul Aziz Al-Saud (Committee on the Elimination of Racial Discrimination, 2001; and Royal Embassy of Saudi Arabia, 2003). Assisting King Fahd in his duties are Crown Prince Abdullah Bin Abdul Aziz Al-Saud and Prince Sultan Bin Abdul Aziz Al-Saud.

The government of Saudi Arabia has always rejected the idea of adopting a secular written constitution, arguing that the constitution of the country already existed, namely: the Qur`an, the Muslim holy book, and the Sunnah of the prophet Mohammed (the teachings and deeds of the Prophet Muhammad), God's prayers and peace be upon him.

The Basic Law adopted in 1992 declared that Saudi Arabia is a monarchy ruled by the sons and grandsons of King Abdul Aziz Al-Saud, and that the Holy Qur'an is the constitution of the country, which is governed on the basis of Islamic law (Shari'ah) and on decrees promulgated by the Council of Ministers. Shari'ah is based on the provisions of the Holy Qur'an, the Sunnah (the teachings and deeds of the Prophet Muhammad) and the consensus of the 'Ulema' (religious scholars) and legal analogy, which is governed on the basis of Islamic law (Shari'ah) and on decrees promulgated by the Council of Ministers (Human Rights Watch Report, 1992).

3.2.2. Saudi Legislation

Chapter I, Article 1 of the Basic Law explicitly provides that Saudi Arabia's only "constitution" are the Qur'an and the Sunnah. Article 1 states, "the Kingdom of Saudi Arabia is a sovereign Arab Islamic state with Islam as its religion; God's Book and the Sunnah of His Prophet, God's prayers and peace be upon him, are its constitution, Arabic is its language and Riyadh is its capital" (Committee on the Elimination of Racial Discrimination, 2001; and Royal Embassy of Saudi Arabia, 2003).

Legislation and decision-making in Saudi Arabia is consultative, with an emphasis on reaching consensus. Historically, King Abdul Aziz Al-Saud founded a Majlis Al-Shura (Consultative Council) as early as 1927 (Long, 1997). This Council was later expanded to 20 members, and was chaired by the king's son, Prince Faisal Bin Abdul Aziz Al-Saud. The Council was expanded to 25 members in the early 1950s, but its functions were then transferred to the Cabinet (Dekmejian, 1998; and Aba-Namay, 1998). In 1997, King Fahd expanded the Consultative (Shura) Council to 90 members (Dekmejian, 1998; and Aba-Namay, 1998). The extension of the Majlis Al-Shura to 150 members in 2004 marks a shift towards a Western-style representative democracy. The Majlis would have a four-year term of office, and the responsibility to examine plans for economic and social development, question Cabinet members, examine annual plans submitted by each ministry, and propose new laws or amendments (Dekmejian, 1998; Aba-Namay, 1998).

In 1953, the king appointed a Council of Ministers, which has since advised on the formulation of general policy and helps direct the activities of the growing bureaucracy. The Council of Ministers sets internal, external, financial, economic, educational and military policies, as well as other affairs of the state. The Council supervises the implementation of these policies. It has legislative, executive and administrative authorities. The Council is the final authority on financial affairs. This Council consists of a prime minister, the first and second deputy prime ministers, 20 ministers, two ministers of state and a small number of advisers and heads of major autonomous organizations (Long, 1997). Saudi laws are promulgated by a resolution of the Council of Ministers, and are proposed by the King, senior ruling princes and key Ministers. They must be ratified by royal decree, and be compatible with the Shari'ah, and are increasingly subject to informal debate or review within the Majlis Al-Shura.

The Saudi legal system is administered according to the Shari'ah by a system of religious courts. Judges are appointed by the king on the recommendation of the Supreme Judicial Council, composed of 12 senior jurists. The independence of the judiciary is protected by law. The king acts as the highest court of appeal and has the power to pardon. Access to high officials (usually at a Majlis, or public audience) and the right to petition them directly are well-established traditions. The kingdom is divided into 13 provinces[1] governed by princes or close relatives of the royal family. All governors are appointed by the King (Country Reports on Human Rights Practices, 2002; US State Department Human Rights Report, 1998).

3.2.3. Saudi 5-Year Development Plans

The development of sound corporate governance in Saudi Arabia can be traced through an analysis of the country's five-year plans. For the past 25 years the economic development of Saudi Arabia has been governed by five-year economic plans. Through the five-year development plans, the government has sought to allocate its petroleum income to transform its relatively undeveloped, oil-based economy into that of a modern industrial state while maintaining the kingdom's traditional Islamic values and customs. In the course of the past few decades, the massive government investments in physical and social infrastructure in the context of successive five-year development plans have transformed the Saudi economy into a modern state with a well-diversified economy.

Saudi Arabia's first (1970-75) and second (1976-80) development plans emphasized infrastructure, e.g., highways, power generation, seaports, etc. (Kingdom of Saudi Arabia, 1970, 1975). Those two plans were silent on corporate governance issues. For the third plan (1980-85), the emphasis rose markedly on education, health, and social services (Kingdom of Saudi Arabia, 1980). The development of standards and quality marks in the Second and Third Plans is seen solely as an aid to protecting

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[1] Al-Bahah, Al-Hudud Al-Shamaliyah, Al-Jawf, Al-Madinah, Al-Qassim, Al-Riyad, Al-Sharqiyah, Aseer, Ha'il, Jizan, Makkah, Najran and Tabuk.

the nation's development. In the fourth plan (1985-90), private enterprise was encouraged and foreign investment in the form of joint ventures with Saudi public and private companies was welcomed (Kingdom of Saudi Arabia, 1985). The private sector became more important, rising to 70% of non-oil GDP by 1987. While still concentrated in trade and commerce, private investment increased in industry, agriculture, banking, and construction companies (Central Intelligence Agency, 2005). However, none of the First and Second Plan's specific objectives mentioned corporate governance.

The fifth plan (1990-95) emphasized consolidation of the country's defences; improved and more efficient government social services; regional development; and creating greater private-sector employment opportunities for Saudis by reducing the number of foreign workers (Kingdom of Saudi Arabia, 1990). The sixth plan (1996-2000) focused on lowering the cost of government services without cutting them and sought to expand educational training programs (Kingdom of Saudi Arabia, 1995). The plan called for reducing the kingdom's dependence on the petroleum sector by diversifying economic activity, particularly in the private sector, with special emphasis on industry and agriculture (Kingdom of Saudi Arabia, 1995). These two plans do begin indirectly to recognize the role of corporate governance in promoting economic development; in particular, both sides of the market are explicitly recognized in the justification for a standards system.

The seventh plan (2000-2005) focuses more on economic diversification and a greater role for the private sector in the Saudi economy (Kingdom of Saudi Arabia, 2000). For the period 2000-05, the Saudi Government aims at an average GDP growth rate of 3.16% each year, with projected growths of 5.04% for the private sector and 4.01% for the non-oil sector. The government also has set a target of creating 817,300 new jobs for Saudi nationals. The Seventh Development Plan emphasizes the need to develop human resources. Development of the private sector features strongly and privatization of the public sector, including airlines, telecommunications and electricity, is a high priority. The plan also acknowledges the need for continuous expansion of the social and economic infrastructure, particularly hospitals, schools and transport facilities, to meet growing demand. The Seventh Development Plan also calls for development of the stock market. At present it is an over-the-counter, highly regulated market connected to an Electronic Share Information System (ESIS) that offers centralized trading and information through the commercial banks (Kingdom of Saudi Arabia, 2000).

Thus, whilst the Kingdom's development plans do mention, indirectly, corporate governance issues, there is often little more than a nod in their direction. Certainly, there does not seem to be a clear notice of what corporate governance might be about.

3.3. SAUDI ECONOMIC OUTLOOK

The Saudi Economy is an oil-based one. The commercial oil exploitation began after World War II. Saudi Arabia has the world's largest oil reserves, 25 per cent of the world's total (Ward, 2002). Oil revenues allowed successive governments to develop the Kingdom's infrastructure, agriculture and industry. Saudi Arabia's huge oil reserves and mineral resources, expanding domestic market, liberal labor policies, increasing number of privatization targets and generous package of investment incentives make it one of the best investment locations in the Middle East (Al-Sayari, 2003).

The Gulf War in 1990-1991 resulted in a substantial increase in defence-related spending, which, in turn, increased economic activity and spurred an increase in investment in local industry. In this period, the Kingdom moved, in some cases assisted by government subsidies, towards self-reliance in agricultural and dairy products, household goods and furnishings, construction materials, pharmaceuticals and a growing list of appliances and electronic components.

From 1993 to 1995, another downturn in the oil market, government budgeted expenditure was reduced by approximately 24 per cent from $52 billion to around $40 billion (Samba Financial Group, 2002). The Gulf War period had resulted in substantial budget deficits, as had the mid-to-late 1980s, so that by 1995 significant fiscal imbalances were starting to appear, particularly an increasing debt burden, albeit all domestic. This resulted in the austerity budgets of 1994 and 1995. In 1996, the recently appointed cabinet embarked on a multi-year program of improved fiscal discipline aimed at gradual elimination of deficits, privatization, and turning to the private sector as the engine of future growth. In the mid-1990s the maturing of the baby boom that began in the early 1970s raised the problem of emerging unemployment among Saudi youth to a high priority of economic policy. The government was on a path to achieve its fiscal goals in 1996 and 1997, as revenues increased and spending was constrained. The oil price recovery beginning in the second quarter of 1999 allowed the government to improve its fiscal performance (Table 3-1).

The Kingdom also has stressed the development of non-oil industries and offered incentives to businesses to initiate industrial activities. According to the Ministry of Industry, in 1980, Saudi Arabia had 730 industrial plants with total invested capital of $6.3 billion (Samba Financial Group, 2004b). At year-end 2000, the number of plants had grown to 4,836 with total invested capital of $71.9 billion. These included over 400 joint ventures with foreign companies. The government has sought to encourage foreign investment in Saudi Arabia. There are no foreign exchange controls and the Saudi riyal has been pegged to the U.S. dollar at a rate of 3.75 riyals to the dollar since 1986 (Samba Financial Group, 2002). A new foreign direct investment law was issued in April 2000 which reduced tax rates on foreign owners' corporate profits from maximum 45 per cent to maximum 30 per cent, allowed foreigners to own land where they do business and sponsor their own foreign employees, and gave access to other incentives, such as low-cost financing, previously available only to majority Saudi-owned entities (Samba Financial Group, 2000).

Saudi Arabia is a founding member of the Organization of Petroleum Exporting Countries (OPEC), which was established in 1960 to coordinate the petroleum-related policies of the member petroleum exporting countries. Saudi Arabia restrains its crude oil output under the current OPEC crude oil production quota, which is 7 million barrels per day for Saudi Arabia in 2002. A 2004 average oil price for Saudi oil of $41.33 per barrel (Table 3-1) and average production of 10.4 million barrel per day would satisfy the budget revenue projection (Samba Financial Group, 2004a; and Energy Administration Information, 2005b).

Table 3-1 Saudi Arabia Key Economic Data
(billion US$ unless noted otherwise)

	1998	1999	2000	2001	2002	2003	2004	2005f
Nominal GDP	145.77	160.96	188.44	183.01	188.53	212.53	248.48	229.87
% Change	-11.5	10.4	17.1	-2.9	3.0	12.7	16.9	-7.5
Real GDP (%Change)	2.80	-0.80	4.90	1.20	0.74	6.40	5.30	4.25
Oil	3.20	-7.50	6.90	-1.20	-5.00	14.30	5.90	2.00
Non-Oil	2.60	4.20	4.30	3.50	4.20	3.40	5.70	6.00
Government	1.90	0.90	3.20	1.70	1.00	1.50	4.00	4.00
Unemployment (Males) (% of Saudi labor force)	N/A	6.66	6.54	6.82	7.57	8.20	8.50	8.80
Population (Million)	19.40	19.89	20.85	21.44	22.04	22.67	23.30	24.01
Saudi	14.45	14.87	15.59	16.03	16.49	16.96	17.50	18.06
Non-Saudi	4.96	5.02	5.26	5.40	5.55	5.71	5.80	5.95
GDP/Capita	7,513	8,092	9,038	8,538	8,553	9,375	10,664	9,574
Oil Price ($/barrel)								
West Texas Intermediate	14.00	19.62	30.61	25.76	26.57	29.00	41.33	35.00
Saudi Average	11.30	16.88	26.81	21.84	23.72	27.00	35.17	30.00
Current Account	-13.15	0.41	14.32	9.36	11.87	29.66	51.50	30.70
As percent of GDP	-9.02	0.26	7.60	5.11	6.30	13.96	20.73	13.36
Government Budget Balance	-12.92	-9.70	6.06	-7.19	-5.47	9.60	26.13	2.00
Revenues	37.76	39.32	68.82	60.84	56.80	78.13	104.80	86.00
Expenditures	50.68	49.02	62.75	68.04	62.27	68.53	68.67	84.00
Budget balance as percent of GDP	-8.9	-6.0	3.2	-3.9	-2.9	4.5	10.5	0.9
Government Domestic Debt	169.01	166.67	164.27	170.67	176	176	163.73	161.07
As percent of GDP	116	119	87	93	93	83	66	70
Official Foreign Assets	78.34	69.35	73.45	82.18	77.30	95.00	128.00	132.50
Central Bank	46.63	39.01	40.70	48.28	41.70	57.00	88.00	90.00
Government Pension Funds	31.71	30.34	32.75	33.90	35.60	38.00	40.00	42.5
Cost of Living (% Change)	-0.20	-1.20	-1.00	-.080	-0.40	0.50	0.20	0.40

Source: Samba Financial Group (2005)

Ali Al-Naimi, the Minister of Petroleum and Mineral Resources in Saudi Arabia, (1999) said that it costs Saudi Arabia less than 10 cents per barrel to discover new reserves (Al-Naimi, 1999). Saudi Arabia currently sells 5 grades of crude oil to the international markets—Arab Heavy, Arab Medium, Arab Light, Arab Extra Light, and Arab Super Light (Croft, 2005). Energy Administration Information (2005b: Saudi Arabian Section) stated, Saudi Arabia ranks as the first or second largest crude oil producer in the world, and is a leader in OPEC's production quota decisions. As such, Saudi Arabia was a critically important player behind the oil price collapse of late 1997 through early 1999, and also in actions taken by world oil producers which have led to a tripling in oil prices by the fall of 2000. During 2004, Saudi Arabia produced an estimated 10.4 million bbl/d of oil (32% of total OPEC oil production), with net export of around 8.7 million bbl/d (the comparable figures for 2003 as a whole were 9.9 million bbl/d and 8.3 million bbl/d, respectively).

Oil and gas exploration and production, refining, marketing and distribution are managed within the Kingdom by Saudi Aramco. Under an agreement reached in 1978, the Saudi Arabian Government purchased the holdings of the foreign shareholders in what was then Aramco and the company was reorganized as Saudi Aramco (Samba Financial Group, 2002). Overseas, Saudi Aramco has invested in oil refining and distribution companies so that it can capture downstream profits as well. The Kingdom's long-term objective is to shift the domestic uses of energy from oil to gas, thereby freeing more oil production for export. In this regard, the Kingdom has invited foreign oil companies to develop gas in the kingdom for domestic use. This "Gas Initiative" is at an advanced stage of negotiation, and initial development activities began in 2003 (Samba Financial Group, 2002).

Oil is still the anchor of the Saudi economy, and the Kingdom earned $106 billion in oil export revenues in 2004, the highest in its history, and well above the average of $69 billion for the previous 5 years. This resulted in a current account surplus of $51.5 billion, and a fiscal surplus of $26.1 billion (SAMBA, 2005).

Continued strength in the global economy in 2005, and thus in oil demand growth, as well as continued tension in major oil producing countries, such as Iraq and Russia, portend another good year for Saudi oil revenues. We believe prices for Saudi oil will average $30 per barrel for the year, and production will decline modestly from the 9 million b/d average of 2004, resulting in lower, but still strong, oil export revenues of $90 billion for Saudi Arabia in 2005. This will again be well above the conservative forecast to meet the Kingdom's 2005 budget, which we estimate was $25 per barrel, and likely result in fiscal and current account surpluses, more government debt relief, and further build-up of government reserves (SAMBA, 2005: p.4).

3.3.1. Private Sector

During the last decade of the 20th century, the private sector contributed more to the country's economy than did the oil sector. In fact, the private sector constituted 42 per cent of the country's Gross Domestic Product (GDP) for 1999, which amounted to US$139 billion (Royal Embassy of Saudi Arabia in London, 2003).

The Saudi Arabian Basic Industries Corporation (SABIC) allows for private businesses to develop and contribute to the economy. SABIC is said to be the "backbone of Saudi Arabia's successful industrialization". By 1999, it had 15 major plants operating in Jubail, Yanbu and Jeddah, with an annual production of 25.5 million metric tons of chemicals, polymers, plastics, industrial gases, fertilizers, steel and other metals. Other SABIC products are used as feedstock by secondary and support industries to produce consumer goods (Royal Embassy of Saudi Arabia in London, 2003).

The Kingdom of Saudi Arabia follows a free trade policy, believing that such a policy and the competition it encourages is the most effective way of utilizing resources efficiently, of employing those resources to meet the changing needs of society, and of providing consumers with the greatest degree of choice. This policy has lead the Government to encourage the private sector of the economy to become as efficient and competitive as possible. Fledgling Saudi industries need help (in the form of grants, soft loans, or, in some instances, even protective tariffs), but the longer-term aim is to generate a private industrial sector capable of facing local and fair foreign competition, of meeting the Kingdom's own industrial needs as far as practical and, indeed, of exporting Saudi goods to other Arab States and beyond.

The investment environment in the Kingdom reflects traditions of liberal and open markets and private-enterprise-friendly policies (Al-Sayari, 2003). Saudi Arabia's leadership is moving towards establishing a free market economy. Although parastatals still dominate the economic output, there has been decisive movement by the Crown Prince to open up the economy to foreign investment and level the playing field for foreign investors.

As part of this economic strategy, the Government is progressively privatising public organizations, encouraging both domestic and foreign investment in the Kingdom's industrial sector. The clearest indication of the Kingdom's future policies for the private sector is provided by the Seventh Development Plan (Kingdom of Saudi Arabia, 1970, 1975, 1980, 1985, 1990, 1995, and 2000).

To stimulate private sector growth, the Saudi government has established a number of institutions including (Al-Sayari, 2003):

- the Supreme Economic Council;
- the Supreme Council for Petroleum and Mineral Resources;
- the Saudi Arabian General Investment Authority;
- the Supreme Commission for Tourism;
- Human Resources Development Fund; and
- the Supreme Council for Human Resources.

Furthermore, a number of new laws and regulatory guidelines has been enacted to speed up economic liberalization aimed at further opening Saudi markets and ensuring stability for investors. The Foreign Investment Law (2000) allows foreigners to invest in most sectors of the economy. It also allows foreign investors and their non-Saudi staff to be sponsored by the licensed facility, and entitles foreign investors to up to 100% ownership.

Realizing the importance of privatisation, Saudi Arabia issued the Cabinet Decree No. 60 on 1/4/1418H (5/8/1997) to ensure a continued increase in the share of the private sector and its expanded participation in the national economy. The Decree established eight objectives of privatisation in Saudi Arabia and the principles to be taken into account in order to achieve these objectives (the objectives are translated into English: see U.S.-Saudi Arabian Business Council, 2003b). The government's privatisation plans include identification of a host of economic sectors to be opened for privatisation, such as telecommunications, electricity, airlines, postal services, railways, port services and water utility. This was reinforced in 2002 with a further announcement which confirmed an Initial Public Offering for Saudi Telecom. The general objectives and strategic principles of the Seventh Development Plan, issued by Cabinet Decree No. 58 in 2000 (Kingdom of Saudi Arabia, 2000) defined the eighth privatisation objective as "increasing the participation of the private sector in activities related to economic and social development" (Third, Seventh and Eighth Basic Principle of Seventh Development Plan, Kingdom of Saudi Arabia, 2000).

The private sector will benefit from privatisation in several ways (U.S.-Saudi Arabian Business Council, 2003b):

- for a start it will become bigger, as a result of the transfer from public to private;
- the efficiency and service gains will benefit the private sector, in lowering its costs and thereby improving its overall competitiveness;
- the addition of large professionally run private sector entities will help improve the overall corporate governance climate; and
- the attendant liberalization measures will create new private sector business opportunities.

3.3.2. Saudi Financial Sector

Saudi Arabia has established a sound regulatory and financial infrastructure based on financial standards and payment systems equivalent to those in major industrial countries. The result is a strong banking sector that benefits from strong management and the most sophisticated technologies. The reliability of this financial infrastructure makes the Kingdom an attractive destination for foreign investment.

The financial system in Saudi Arabia consists of the central bank (Saudi Arabian Monetary Agency 'SAMA'), the commercial banks, the specialized credit institutions and the stock market. Banking is regulated under the Banking Control Law issued by royal decree in 1966 (Saudi Arabia General Investment Authority, 2005). The Council of Ministers issues licences for the establishment of banks, based on recommendations from the Minister of Finance after review by the central bank.

3.3.2.1. The Central Bank (Saudi Arabian Monetary Agency)

The Kingdom's central bank is the Saudi Arabian Monetary Agency (SAMA), which stands at the apex of the financial system. It acts as the government's bank, regulates and monitors commercial banks and manages the Kingdom's foreign assets. SAMA executes the Kingdom's monetary policy and issues the country's currency. SAMA and the banks have invested substantial resources in upgrading the Kingdom's banking technology to cover a wide range of items such as ATMs, electronic clearing and share trading. The Electronic Funds Transfer System provides considerable advantages for banks and their customers, permitting direct transfers of payments through an instantaneous, safe and accurate payments mechanism. The electronic connection among the settlement systems, the payments network and the share trading system is among the most modern in the world (Nova Stars Information Services, 1998). SAMA is a member of the Bank for International Settlements.

3.3.2.2. The Commercial Banks

The Saudi banking industry remains a consistently strong sector of the Kingdom's economy. There are 14 licensed commercial banks (Table 3-2) in Saudi Arabia (the U.S.-Saudi Arabia Business Council, 2003a).

The banking structure in Saudi Arabia is based on branch banking, with 1,201 commercial bank branches in the Kingdom (Al-Jasser, 2003). The expansion of branch networks has been encouraged as the economy has grown. The last ten years have seen substantial growth in Saudi Arabia's domestic banking business in terms of products, services, technological sophistication, capitalization, and earnings. Banks in Saudi Arabia have already started to take advantage of the increased opportunities associated with the Internet by setting up e-commerce programs (Jasimuddin, 2001). They are relying on e-commerce for strategies to enhance customer services and convenience for clients. The potential for on-line billing and business-to-business markets is developing rapidly in the Kingdom.

Table 3-2 Commercial Banks in Saudi Arabia

Classification	Name of Bank
Saudi Banks	Al-Rajhi Banking and Investment Corporation
	Arab National Bank
	Bank Al-Jazira
	Banque Saudi Fransi
	National Commercial Bank
	Riyad Bank
	Saudi American Bank
	The Saudi British Bank
	Saudi Hollandi Bank
	Saudi Investment Bank
Foreign Banks Licensed and Operating	Gulf International Bank
Foreign Banks Licensed but not yet Operating as of January 2004	Emirates Bank International
	National Bank of Kuwait
	National Bank of Bahrain

3.3.2.3. The Specialized Funds

In addition to commercial banks, there are several domestic specialized credit institutions which disburse loans and advances to Saudi individuals and companies world-wide (Samba Financial Group, 2002; and Nova Stars Information Services, 1998). Those institutions are:

- Saudi Arabian Agricultural Bank
- Public Investment Fund
- Real Estate Development Fund
- Saudi Credit Bank
- Saudi Industrial Development Fund

Total disbursements by these institutions from their inception through 2003 exceeded \$81 billion. Total assets increased by 6.3 percent over 2002 to \$65.2 billion in 2003. Actual loan disbursements from the five institutions in 2003 amounted to

$1.6 billion, with loan repayments at $1.3 billion. At the end of 2003, total outstanding loans from the institutions stood at $40.9 billion, a 1.1 percent rise over 2002 (the U.S.-Saudi Arabia Business Council, 2003a).

3.3.3. Saudi Corporate (Joint Stock) Sector

The history of the Saudi joint stock companies may be traced to the 1930's when the first joint stock company, the Arab Automobile Company, was established in 1934 (see the Committee on Payment and Settlement Systems, 2003). In 1954, the Arabian Cement Company went public and was followed by the privatization of three electricity companies. In response to the needs of the economic development of that period, more joint stock companies were established. By 1975 there were 14 public companies. The rapid economic expansion and Saudi-isation of foreign banks in the 1970s led to the establishment of a number of large corporations and joint venture banks. Major share offerings were made to the public during this period (see the Committee on Payment and Settlement Systems, 2003).

In 1985, the Saudi government placed all stock trading under the supervision and control of the Saudi Arabian Monetary Agency (SAMA) and discontinued the existing broker-based stock trading system (Al-Jasser, 2003). The government then authorized the domestic commercial banks to act as brokers in order to protect the market against the adverse effects of speculation and to help it develop and mature (Al-Jasser, 2003). This was also done so that the stock market could develop in a manner that would contribute to national development and was consistent with its policy of greater private sector participation.

The Saudi Share Market Index was included for the first time in 1998 as part of the emerging stock markets database supervised by the International Finance Corporation (IFC) of the World Bank (the U.S.-Saudi Arabia Business Council, 2003a). This supervision indicates the IFC's recognition of the importance of the Saudi Share Market, which occupies an advanced position amongst new markets in many important indicators, including market value, the daily average of shares value, and the price percentage of the annual profit. Saudi banks managed 138 investment portfolios valued at US$13.4 billion in 2001. Domestic investments made up 60.1

percent of the investment funds, or $8.1 billion in 2001, an 83.5 percent increase from 2000 (the U.S.-Saudi Arabia Business Council, 2003a).

The Kingdom's share market has improved considerably since 1999, showing a 72 per cent growth in the three-year period between 1999 and 2001 and performing better than international and Middle East indices. The market rose 43 percent in 1999, 11.3 percent in 2000, 7.6 percent in 2001, 2.3 percent in 2002, and its largest ever increase of 76.3 percent in 2003 (the U.S.-Saudi Arabia Business Council, 2003a). The first half of 2004 has seen continued strong performance, showing a 29 percent increase through June 2004 (Embassy of the United States of America, 2004).

There were 71 firms listed on the Tadawul as of May 2004. Saudi Arabia has taken a major stride by providing the opportunity to non-Saudis to participate in the stock market for the first time through the creation of an investment fund for Saudi equities (UAE Interact, 1997). International investors have been approved to participate in the Saudi stock market through mutual funds since 1997 (Royal Embassy of Saudi Arabia in London, 2003). During 1999, investment in portfolios of local stocks managed by Saudi Arabian banks were opened to non-Saudis, which gave them even more channels to invest their savings.

With the opening of the Saudi shares market and an upswing in oil prices, the total value of shares traded on the Saudi stock market increased dramatically. Market capitalization has increased by 650.98% and the all share index has increased by 499.85% (Tadawul, 2004). Table 3-6 shows the Saudi share market statistical summary.

3.3.3.1. Sectors Classification

The joint stock companies listed on the Saudi stock market are currently categorized into the sectors shown in Table 3-3.

Table 3-3 Joint Stock Companies in Saudi Arabia

SECTORS	NUMBER OF COMPANIES
Banking	9
Industrial	25
Cement	8
Service	18
Electricity	1
Telecommunication	1
Agricultural	9
TOTAL	**71**

3.4. CORPORATE GOVERNANCE REGULATORS IN SAUDI ARABIA

Formation and operation of business firms and companies in Saudi Arabia is regulated by the Companies Law[2] promulgated by Royal Decree No. M/6 dated 22/03/1385 Hijri (July 22, 1965)[3], Royal Decree No. M/5 dated 12/02/1387 Hijri (May 22, 1967) and Royal Decree No. M/23 dated 28/06/1402 Hijri (April 23, 1982) amended the regulations for companies (Ministry of Commerce, 1965, 1967, 1982 and 1985). Corporate governance practices in Saudi Arabia are governed by four bodies: the Ministry of Commerce, the Saudi Arabian Monetary Agency (SAMA), the Saudi Stock Exchange (Tadawul) and some professional bodies.

In 1984, a Ministerial Committee consisting of Ministry of Finance and National Economy, Ministry of Commerce and the Saudi Arabian Monetary Agency (SAMA) was formed to regulate and develop the Saudi market. SAMA was additionally charged with the day-to-day regulation of the market. With the aim of improving the regulatory framework, share-trading intermediation was restricted to commercial banks. In 1984, the Saudi Share Registration Company (SSRC) was

[2] Sometimes called the "Regulations for Companies".
[3] Because the lunar year (Hijri) is slightly shorter than the solar year (Gregorian), there is an extra one year every 33.7 years. It is thereby necessary to divide the Islamic lunar by 33.7 and subtract it from that Islamic lunar date. Then add 622 (the year of the Hegira, Muhammad's flight from Mecca to Medina in 622AD).

established by the commercial banks. The company provides central registration facilities for joint stock companies and settles and clears all equity transactions. Automated clearing and settlement were introduced in 1989.

3.4.1. The Ministry of Commerce[4]

The Ministry of Commerce was established by the issuance of the Royal Decrees No. 10/22/5/5703 dated 11-07-1373 Hijri (March 17, 1954) (Ministry of Commerece, 1954). The Ministry of Commerce controls corporate governance and the accounting profession in Saudi Arabia. To guide corporate governance, the Ministry has issued the Saudi Arabian Auditing Standards and the Saudi Arabian Standards of General Presentation and Disclosure (Al-Otaibi et al., 2003). The Saudi Arabian Monetary Agency (SAMA) has issued additional accounting standards for banks.

The Ministry of Commerce is directly responsible for primary market offerings and regulation and supervision of the joint stock companies and all companies operating in Saudi Arabia (Ministry of Commerce, 2003b). The Regulations for Companies (Companies Law, 1965), and its 1967, 1982, 1985, 1987, 1992a,b,c, 1998a,b,c, 1999, 2003a.b amendments, list business forms and structures, of which joint stock companies and limited liability partnerships are the most attractive to foreign investors, and regulate all forms of company in Saudi Arabia (Ministry of Commerce, 1967, 1982, 1985, 1987, 1992a,b,c, 1998a,b,c, 1999, and 2003a.b).

Under Article 1 of the Regulations for Companies (Companies Law, 1965), a company has been defined as a contract pursuant to which each of two or more persons undertake to participate, in an enterprise aiming at profit, by offering in specie or as work a share, for sharing in the profits or losses resulting from such enterprise. Under Article 2, companies can take any of the following forms: General Partnerships; Limited Partnerships; Joint Ventures; Joint Stock (Corporation); Partnerships Limited by Shares; Limited Liability Partnerships; Variable Capital Companies; and Cooperative Companies (Ministry of Commerce, 1965).

[4] Became the Ministry of Commerce & Industry in 2003.

All companies in Saudi Arabia formed in accordance with the Regulations for Companies (Companies Law, 1965) are required by the Ministry of Commerce to comply with Saudi Arabian Generally Accepted Accounting Principles. Such companies are required to have their financial statements audited by an auditor licensed in Saudi Arabia and to file annually with the Ministry of Commerce (Ministry of Commerce, 1992d, 1994). The major accounting and auditing regulations are contained in the:

- Regulations for Companies or Companies Law (Ministry of Commerce, 1965).
- Foreign Capital Investment Act (Ministry of Commerce, 1979).
- Zakat and Tax Regulations (Ministry of Finance, 1950).
- Standards and the Saudi Arabian Standards of General Presentation and Disclosure (Ministry of Commerce, 1992d, 1994).
- Saudi Arabian Accounting Standards (SOCPA)
- Saudi Arabian Auditing Standards (Ministry of Commerce, 1992d, 1994; SOCPA).

The Ministry of Commerce is very strict about the companies' violations to the Companies Law. Very strict punishments have been clarified in the Companies Law (1965: 28) to those who convict breaches. However, no records of convicting breaches of the Companies Law have been fount in either the Ministry of Commerce's website or in the Capital Market Authority's website. The Enforcement Department in the Capital Market Authority monitors compliance with the Companies Law and investigates potential violations or breaches of the Law.

In 1985, the Ministry of Commerce financed a research project that resulted in the publication of a two-volume book. The first volume was entitled "Accounting Objectives and Concepts", and the second volume was entitled "Auditing Standards" (Al-Otaibi et al., 2003). In October 1993, the Saudi Organization of Certified Public Accounting (SOCPA) gave their seal of approval to the two volumes (Saudi Organization of Certified Public Accounting, 1994a,b,c,e,f).

The Ministry of Commerce has given the Saudi Organization of Certified Public Accounting's (SOCPA) board of directors the powers required for realizing the organization's assigned objectives (the objectives are shown in section 3.4.4). The Secretary General of SOCPA executes and follows up Board decisions. Technical committees prepare general rules organizing the profession, including establishing and developing accounting and auditing standards, professional ethics, organizing SOCPA fellowship examination, practice-monitoring programs, etc. These committees are formed from experts and members of high specialization; University staff, practitioners from companies and government departments (Saudi Organization of Certified Public Accounting, 1994a,b,c,d,e,f; 1997a,b,c,d,e). Table 3-4 shows the names of committees concerned and their constitution.

Table 3-4 Committees Organizing the Profession*

Name of Committee	Professional	Academic	Government	Companies	Total
Accounting Standards	4	4	2	3	13
Auditing Standards	4	4	2	1	11
Professional Ethics	3	3	1	2	9
Examinations	3	4	-	1	8
Quality Review	4	3	-	2	9
Education and Training	3	3	1	1	8

Source: (Saudi Organization of Certified Public Accounting, 1994a,b,c,d,e,f; 1997a,b,c,d,e)

The Accounting Standards Committee conducted a comprehensive study on the adequacy of the adopted International Accounting Standards and on previously issued standards (see Table 3-5), which included the objectives and concepts of financial accounting and presentation and a general disclosure standard. It also determined the topics that are considered as significant to be covered by accounting standards, and consequently commenced preparing twenty standards. SOCPA is also working on the preparation of some other standards, such as: fixed assets, intangible assets, accounting for operation and maintenance contracts, accounting for supply and construction contracts, segment reporting, other than temporary impairment, equity method, real estate, lease contracts, government grants and subsidies, employee wages, share dividend, liabilities and contingencies and financial bonds (Ministry of

Commerce, 1992d, 1994; Saudi Organization of Certified Public Accounting, 1994a, 1997e).

The Auditing Standards Committee conducted a comprehensive study covering previously issued auditing standards, which included: professional qualification; integrity, objectivity and independence; due professional care; planning, control and documentation; and evidences of auditing and reporting. The Committee determined the topics for which auditing standards are to be issued. The following are the issued standards: auditing in computer environment; study and assessment of internal control for the purpose of auditing financial statements; special reporting; interim reporting; audit risk and materiality; and attestation standards. The Committee has also decided to start issuing the following standards: audit sampling; related parties transactions; auditor's responsibility to detect and report errors or irregularities; internal auditing for the purpose of auditing financial statements; prospective financial reporting; reports on processing information by service organizations; analytical procedures; and client representations (Saudi Organization of Certified Public Accounting, 1994b,c,e,f).

3.4.1.1. Commercial Registration

- The Statute of Commercial Registration System as contained in the Council of Ministers Resolution No. 54 dated 29-04-1375 H. (December 14, 1955) and No. 112 dated 13/10/1375 H. (May 24, 1956) requires every industrial or commercial establishment, local and foreign, to be registered with the commercial registration offices of the Ministry of Commerce established in all the major towns of the kingdom (Saudi Commercial Office, 2004).

According to the Ministry of Commerce there were 10,000 companies in Saudi Arabia by the end of 2000 with an estimated capital of SR 169.3 billion (US$45.2 billion). Of these, 116 were public incorporated companies (69 registered only) with an estimated capital of SR 87 billion (US$23.2 billion), and 6,238 companies were limited liability companies with a total capital of SR 67.6 billion (US$18 billion). Of the later, 4,980 companies were fully owned by Saudi nationals, 141 companies were joint ventures and 117 Saudi companies were financed by foreign capital (Saudi Arabian General Investment Authority, 2000).

3.4.2. Saudi Arabian Monetary Agency

The Saudi Arabian Monetary Agency (SAMA), the central bank of the Kingdom of Saudi Arabia, was established in 1952. According to Article 1 of the SAMA's Charter (1957) issued by Royal Decree No.23 dated 23-5-1377 (December 16, 1957), the objectives of SAMA include the following (SAMA, 1957):

- to issue and strengthen the Saudi currency and to stabilise its internal and external value;
- to deal with the banking affairs of the government; and,
- to regulate commercial banks and exchange dealers.

A subsequent Royal Decree in 1957 extended SAMA's objectives to regulating exchange dealers and managing the country's official foreign exchange reserves. In 1959 a Currency Law was issued which conferred on SAMA the sole privilege of minting, printing and issuance of the Saudi currency as determined by the Council of Ministers (Al-Sayari, 2002).

The Banking Control Law of 1966, issued by Royal Decree No. M/5 dated 22-2-1386 (June 12, 1966), gives SAMA broad powers to regulate and supervise Saudi banks and to safeguard the banking system (SAMA, 1966). It defines banking business, confers licensing power, determines capital adequacy, prescribes reserve requirements, grants authority to formulate credit policy and deals with the usual banking supervisory issues. These include conferral of enabling powers to issue rules and guidelines to banks and to lay down conditions for certain actions and transactions. Consequently, the Agency can issue rules and guidelines for any new type of banking transaction or product, including payment cards, ATMs and EFTPOS. It is by judicious exercise of these regulatory powers that SAMA has sought to develop the payment and settlement services in the country with the full participation of the banks (Committee on Payment and Settlement Systems, 2003).

SAMA plays an active role in the development of corporate governance in Saudi Arabia, especially for the financial sector. To support the issuance and trading of the shares of Saudi joint stock companies and the development of brokerage and investment management services by the commercial banks, SAMA, in 1990, created an electronic screen-based trading and integrated settlement system (the Electronic Securities and Information System, ESIS). During 2001, SAMA upgraded its ESIS to a new internet-based system, *Tadawul.* Tadawul (an Arabic word meaning "exchange") provides a continuous, order-driven market, with up-to-the-minute price, volume and company information. It concentrates all local equity trading into a single market. Transfer of ownership occurs immediately after matching of buy-and-sell orders and all trades are settled on the day of execution. All brokerage services are provided through the commercial banks (Committee on Payment and Settlement Systems, 2003).

Since the SAMA's third and main objective is to regulate the commercial banks operating in Saudi Arabia, SAMA has issued a series of directives to the banks with regard to corporate governance. In 1982, SAMA issued a "Clarifying Memorandum on Powers and Responsibilities of Members of the Board of Directors of Saudi Commercial Banks" and in 1988, SAMA issued guidance on "Internal Controls in Commercial Banks". In 1990, SAMA issued "Accounting Standards for Commercial Banks in Saudi Arabia". SAMA also issued detailed guidance to the Banks in 1994 on the "Role of the Audit Committees" to support the legislation for all corporations to form audit committees. In 1996, SAMA issued rules on "Special Examinations", and subsequently conducted such inspections in all banks. These rules and regulations taken together provide a strong infrastructure for corporate governance in the Saudi banking system (Al-Sayari, 2002).

The Charter of the Saudi Arabian Monetary Agency (SAMA, 1957) and the Banking Control Law (SAMA, 1966) empowers the SAMA to issue rules and regulations to Saudi banks, for achieving national policy objectives and for safeguarding the soundness of corporate governance of the banking system in Saudi Arabia. In this context, the Banking Control Law specifies rules relating to capital adequacy, liquidity, legal reserves, loan concentration, prudential returns, reserves with SAMA, etc. Furthermore, Article 16 of the Banking Control Law permits the Agency to issue general rules regarding lending policies, collaterals, and various banking transactions (SAMA, 1966). Over the years, the Agency has issued many rules and regulations relating to provisioning, dividends policy, mutual funds, etc. (SAMA, 1990).

The SAMA forces the board of directors of all banks operating in Saudi Arabia to pass a resolution to establish a committee of the board to be known as the audit committee. Members of the audit committee must be appointed by the board of directors for a period of three years. The committee must comprise at least three and no more than five independent members. The appointment of all members of the committee will be cleared with SAMA. Members of the committee should have a sound knowledge of business, objectivity, good judgment, combined with knowledge of financial reporting, accounting, and auditing of banks. In addition to the audit committee members, financial controllers, chief accountants, head of accounts, head of internal audit, representative from external auditors shall normally attend meetings. The committee shall meet at least three but possibly more times a year contingent upon the specific circumstances (SAMA, 1994).

3.4.3. Saudi Stock Market

On November 23, 1984, Royal Decree No. 1230/8 was issued to establish the Saudi Share Registration Company (SSRC), which was to be sponsored by local commercial banks under the supervision of the Saudi Arabian Monetary Agency (SAMA) (Almossawi, 2004). The SSRC is currently in charge of managing the records of shareholders and share certificates, as well as providing support facilities for transactions and transferring and registering ownership of transactions automatically. This was the beginning of a new era for establishing a specific regulatory system for electronic share trading (Almossawi, 2004).

The existing stock trading system in the Kingdom – the Electronic Securities Information System (ESIS) – was introduced to the Saudi market gradually in the second half of 1990. It is an electronic screen-based system using a central host computer in the SAMA head office in Riyadh, the capital city (U.S.-Saudi Arabian Business Council, 2003a). The system is connected to many trading lounges of local banks in the Kingdom. Banks are not, however, allowed to buy and sell stocks for their own accounts or maintain inventory for trading purposes. ESIS trading ensures the following: information transparency, fairness, narrow price spreads, efficient trading cycles, liquidity, control and security (Committee on Payment and Settlement Systems, 2003).

The Saudi Stock Market began to emerge in the late 1970's when the number of joint stock companies increased considerably. The government nationalized (Saudi-ised) foreign banks and their shares were offered to Saudi nationals. This contributed to the increase of shares available to the public and the need for share trading. However, due to the lack of trading regulation at the time, stock trading was fairly limited through the early 1980's when oil prices were increasing which, in turn, resulted in an increase in both volume of trading and market capitalization.

In July 2003, the Saudi Cabinet approved a new Capital Markets Law (Saudi Arabian General Investment Authority, 2003). The law is a milestone for economic liberalization in the Kingdom and is expected to provide a legal and regulatory framework for all capital-related activities, such as securities trading. It is also expected to increase transparency and accountability and attract foreign investment. According to this law, all rights and assets of the current stock exchange and the Saudi Company for Stock Registration would be transferred to the capital market and a new body called the Capital Market Authority (CMA), which was created by Royal Decree No. (M/30) dated 2-6-1424 H. (June 16, 2003). A new stock market named the Saudi Capital Market 'Tadawul' will be established in the form of a joint-stock company to manage and facilitate stock exchange activities and set out and execute the criteria for middlemen and agents (Khayyat, 2003).

The Capital Market Authority (CMA) functions are to regulate and develop the Saudi Arabian Capital Market. It issues the required rules and regulations for the implementation of the provisions of Capital Market Law aimed at creating an appropriate investment environment. The CMA enjoys authority to: regulate and develop the capital market; protect investors and the general public from unfair and unsound practices involving fraud, deceit, cheating, manipulation and insider trading; chieve fairness, efficiency and transparency in securities transactions; develop measures to reduce the risks pertaining to securities transactions; develop, regulate and monitor the issuance and trading in securities; regulate and monitor the activities of entities subject to the control of the CMA; regulate and monitor full disclosure of information related to securities and their issuers; and regulate proxy and purchase requests and public share offerings (Capital Market Authority, 2004).

Article 20 of the Capital Markets Law (Saudi Arabian General Investment Authority, 2003: p.10) stated:

> A market is to be established in the Kingdom for trading in securities and it will be called the "Securities and Exchange", having a legal status of a joint-stock company in pursuance of the provisions of this Law. This Exchange will be the sole entity authorized to operate in trading of securities in the Kingdom.
>
> The purposes of the Exchange include,
>
> - ensuring fair, efficient and transparent listing requirements, trading rules and technical mechanisms and information for securities listed on the Exchange;
> - providing through its Share Deposit Center reliable and rapid settlement and clearance procedures;
> - establishing and enforcing professional standards for its brokers and their agents; and
> - assuring the financial strength of its brokers through establishing and periodically reviewing compliance with its capital adequacy requirements, including such arrangements as it believes appropriate to protect the funds and securities in the custody of brokers.

3.4.4. Professional Bodies

There are some other regulators for corporate governance in Saudi Arabia, the professional bodies. The professional bodies are those in charge of organizing and regulating the accounting and the auditing professions in the Kingdom. Accountants, auditors, legal consultants and all other professional bodies must be licensed by the Ministry of Commerce.

The Companies Law (1965) required companies to prepare financial statements to be audited by a licensed auditor. The Law also included provisions that govern the assignment of a CPA and a definition of the scope of his responsibilities. In 1968, a new law specified certain requirements that should be complied with in order to practise accounting and auditing in Saudi Arabia. In 1974, the Ministry of Commerce issued the CPA Regulations, which was the first step to organize the profession in the Kingdom. A higher committee for certified public accounting was established, in accordance with the Regulation, to supervise and monitor the profession (Saudi Organisation for Certified Public Accountants, 1994a, 1994b, and 1994c).

In 1981, King Saud University commenced a series of symposiums about accounting development methods in Saudi Arabia, in order to reach suitable recommendations for resolving any obstacles that may hinder the development of the profession. In 1981, the Academic Board allowed King Saud University to establish the first accounting and auditing professional body in Saudi Arabia, the Saudi Accounting Association. The purpose of the Association is to promote accountancy thoughts, exchange of ideas, consultation and conducting studies (El-Saqa, 1997).

In 1992, the second professional body, Saudi Organization for Certified Public Accounting "SOCPA", was established by the Royal Decree No. M/12 (Ministry of Commerce, 1992; SOCPA, 1994a,b,c,d). Article (19) mentioned that an Organization shall be established under the name of (Saudi Organization for Certified Public Accounting "SOCPA"). It shall operate under the supervision of the Ministry of Commerce in order to promote the accounting and auditing professions and all matters that might lead to the development of the profession and improve its status. Following is an executive summary of the SOCPA objectives and the standards issued by them (Table 3-5) (Saudi Organization for Certified Public Accountants, 1994 a, b, c, and d).

- Review, develop and approve accounting standards.
- Review, develop and approve auditing standards.
- Establish the necessary rules for fellowship certificate examination (CPA exam.) including professional, practical and scientific aspects of audit profession and applicable regulations.
- Organize continuous education programs.
- Establish an appropriate quality review program in order to ensure that Certified Public Accountants implement professional standards and comply with the provisions of Certified Public Accountants Regulations and relevant by-laws.
- Conduct special research work and studies covering accounting, auditing and other related subjects.
- Publish periodicals, books and bulletins covering accountancy and audit related subjects.
- Participate in local and international committees and symposiums relating to the profession of accounting and auditing.

Table 3-5 The Standards Issued by the SOCPA

Standard No.	Standard Name	Date of Issue
1	Presentation and general disclosure	1990 (amended 1996)
2	Foreign currency	1997
3	Inventory	1997
4	Related parties' transactions	1997
5	Consolidation and mergers	1997
6	Revenue recognition	1998
7	General and administrative expenses, and sale and distribution expenses.	1998
8	Research and development expenses	1998
9	Investment in equity securities	1998
10	Interim reports	1999
11	Zakat and income tax	1999

Source: SOCPA

3.5. CORPORATE GOVERNANCE DEVELOPMENTS IN SAUDI

The improvements in the Saudi economy (Section 3.2) have brought about a corresponding need to enhance the accountability of the managers of companies in Saudi Arabia with the need to adopt good corporate governance. A direct consequence of this is the initiation of this study in corporate governance in Saudi Arabia that may lead to the implementation of domestic codes in Saudi Arabia.

The assessment of corporate governance is the outcome of the assessment of the four corporate governance legs (mechanisms), namely: shareholder rights; board of directors; audit committee and internal audit; and disclosure and transparency, and testing the intensity of adoption of these mechanisms in the Saudi publicly traded (joint stock) corporations. Therefore, the author intends to describe and develop the situation and real practices of corporate governance in Saudi Arabia. The rules governing each mechanism of the four corporate governance mechanisms in Saudi Arabia are covered in this section.

Accounting practices in Saudi Arabia are regulated by three laws: the Companies Law, Accountancy Law and Income Tax and Zakat Law (Naser et al., 2003). Naser et al. (2003: p.43-44) stated:

> The *Company Law*, the primary authoritative reference for professional accounting practice, includes some accounting guidelines. It determines the legal basis for companies and accountants and its articles deal with the fundamental details of formation, such as registration procedures, minimum capital required number of partners, number of directors, and other related matters. Article 38, for example, asks the board of directors to prepare a balance sheet for every financial year, a profit and loss account, and a report on the company's operations and financial position. It also provides some guidance on auditing and accounting measurement and procedures.
>
> The *Accountancy Law* was enacted by Royal Decree No. 43 (1974) and was the first to regulate the accounting profession in Saudi Arabia. It is still in effect and sets the standards that should be followed by auditors. It consists of 35 articles, which establish the fundamental requirements of practicing accounting services such as registration procedures and fees, qualifications, the responsibilities of the auditor, violation and trial proceedings, and other related issues.
>
> During the past decade, the Ministry of Commerce realized there was an urgent need to update the 1974 Accountancy Law. Accordingly, a new law was enacted by Royal Decree Number 12/M on 13.5.1412 H (1991). This law comprises the following: conditions for registration; registration procedures; the obligations of a chartered accountant; and the establishment of the Saudi Public Accountants' Committee.
>
> The *Income Tax and Zakat Law* was first introduced in Saudi Arabia by Royal Decree No. 17/2/28/3321, dated 21.1.1370H (1950), and has been amended several times. Zakat is a religious duty (tax), in accordance with Islamic Law, charged to Saudi citizens, wholly Saudi-owned companies, and the Saudi portion of profit of companies owned jointly with foreigners. The Zakat is imposed on capital and earnings: all profits, gains, and proceeds from business, industry acquisitions of whatever kind or description, including financial and commercial transactions, and dividends, crops, and livestock.

3.5.1. Shareholder Rights in Saudi Arabia

Trading in shares in Saudi Arabia commenced in 1934 when the first corporation was established in the country. The number of corporations until the early 1970s was only 14. However, as a result of the dramatic increase in oil prices during the 1970s, the number of companies listed on the Saudi stock exchange increased rapidly, reaching 73 companies by 1999 with a market capitalization of almost US$44 billion (Emerging Stock Markets Factbook, 2000; Committee on Payment and Settlement Systems, 2003). The corporations (joint stock companies) in Saudi Arabia are the targeted sample of this thesis.

A joint stock company in Saudi Arabia is a common type of company where shareholders have limited liability and shares are freely transferable. The company is organized around two main institutional bodies: the shareholders and the board of directors. The board oversees the management of the company, and its members are elected by shareholders who meet in general meetings. A joint stock company is owned by five or more individuals or entities. Capital is apportioned into negotiable shares of an equal amount, and shareholders are liable only to the extent of the value of their holdings. The minimum capital requirement is two million Saudi Riyals (SR) (US$533,334) or no less than ten million SR (US$2,666,667) if its shares are offered for public subscription. The par value of each share cannot be less than SR 50 (US$13.3), and upon incorporation, its issued paid-up capital must be no less than one-half of the authorized capital. Prospective joint stock companies involving businesses such as minerals exploitation, administration of public utilities, banking and finance require authorization by Royal Decree prior to incorporation (Info-Prod Research, 1999).

Since the regulation of share trading through commercial banks in 1985, the share market has witnessed significant growth (Table 3-6). Over the period from 1985 to the end of 2004, the number of shares traded has increased by more than 257,450 (10,298/4) per cent and the value traded has gone up by 233,464 (473,029/202.67) per cent. The market value of shares has risen by 1,712 per cent and the general share price index increased to 8,206.23. Over 2.4 million individuals have invested in the shares of Saudi joint-stock companies, that is over 10 percent (see Table 3-1) of the Saudi citizens.

Table 3-6 Share Market Indicators in Saudi Arabia*

End of period	Number of shares traded Million	Value of shares traded Million US$	Market value of shares Billion US$	Number of transactions	General Index (1985 = 1000)
1985	4	202.67	17.87	7,842	690.88
1986	5	221.60	16.80	10,833	646.03
1987	12	449.60	19.47	23,267	780.64
1988	15	543.20	22.93	41,960	892.00
1989	15	897.07	28.53	110,030	1,086.83
1990	17	1,174.13	25.87	85,298	979.80
1991	31	2,273.87	48.27	90,559	1,765.24
1992	35	3,653.07	54.93	272,075	1,888.65
1993	60	4,629.33	52.80	319,582	1,793.30
1994	152	6,632.27	38.67	357,180	1,282.90
1995	117	6,193.87	40.80	291,742	1,367.60
1996	138	6,772.53	45.87	283,759	1,531.00
1997	312	16,549.33	59.47	460,056	1,957.80
1998	293	13,736.00	42.67	376,617	1,413,10
1999	528	15,087.47	61.07	438,226	2,028.53
2000	555	17,411.20	68.00	498,135	2,258.29
2001	691	22,293.87	73.33	605,035	2,430.11
2002	1,736**	35,676.53	74.93	1,033,669	2,518.08
2003	5566	159,069.33	157.33	3,763,403	4,437.58
2004	10298	473,029.07	305.87	13,319,523	8,206.23
2005-Q1	1757	131,021.87	393.33	4,615,084	10,499.26

*	Source: Tadawul (2005)
**	The Suadi Telecommunication was privatized in 2001

Trading in shares in Saudi Arabia was dictated by personal contact between investors and between investors and brokers because the Saudi stock market has always been an informal market and, until 1980, unofficial brokers ran the market without any established trading procedures. In order to protect investors, in 1980 the Saudi Authorities banned the contact with companies or through the conpany's commercial banks (Naser, 1998). Consequently, commercial banks now operate special departments to facilitate trading in shares. In addition to commercial banks, the Saudi Arabian Monetary Agency (SAMA) and the Saudi Share Registration Company (SSRC) are involved in the process of share trading in Saudi Arabia. The executive basis for regulating shares through commercial banks is a system administrated by the following.

- A ministerial committee made up of the Minister of Trade, the Minister of Finance and National Economy and the Governor of the Saudi Arabian Monetary Agency (SAMA).
- A permanent supervisory committee consisting of deputies from the Ministries of Trade, Finance and National Economy and the Governor of the SAMA.
- The Stock Control Department at SAMA, which oversees the implementation of regulations for share trading and daily transactions.

Some shareholders rights are stated clearly in the laws and by-laws of the Saudi Companies Law (1965). There is a regulation that outlines shareholders rights in securing ownership registration, participating and voting in general shareholders meetings, as well as involvement in decisions concerning fundamental corporate changes. Although some shareholders rights are clearly identified in the rules and regulations of Saudi Arabia, unfortunately, there is a gap between what the law states and what is practised.

The general meeting of joint-stock companies is the connecting link between the company's management and the shareholders, allowing them to discuss with the board of directors matters relevant to the company's activities and performance, and to offer constructive proposals to enhance the position of the company in the market. In order to promote the role of the general meetings and stress their importance in undertaking their functions, the Authority has issued general regulations to organize convening of the meeting and to draw the shareholders' attention of the importance of attending such meetings.

Article 84 (Companies Law, 1965) stipulated that at least one ordinary general meeting should be held during the six months following the end of the financial year, to study and discuss the agenda items as indicated by the law such as: the board of director and auditor reports and any other items, in order to advise the shareholders of the company's position and allow them to discuss and comment on all matters related to the company's activities (Article 94). Article 88 stated that the date of the general meeting must be published in a local newspaper at least 25 days prior to the meeting, and the proposed agenda and all related documents should be sent to all shareholders and to the Companies Department at the Ministry of Commerce giving adequate time in advance prior to the meeting.

Article 83 of the Saudi Companies Law (1965) showed that shareholders who own 20 shares and more have the right to attend general meetings. A shareholder could attend general meetings by proxy (Ministry of Commerce, 1965). Article 91 states that general meetings would not be regarded as valid unless shareholders who own at least half of the company's capital attend them; otherwise, another meeting must be called for and conducted during the next thirty days of the previous one (Ministry of Commerce, 1965). For example, the Arabian Industrial Development Co. (NAMA), a Saudi Joint Stock corporation, postponed the general meeting which took place on September 19, 2004 because shareholders who attended owned less than half of the company's capital. Therefore, another meeting was called for which was on September 26, 2004 (Tadawul, 2005).

Article 93 emphasizes that the company's regulations must clarify the voting methods used by their system in general meetings (Ministry of Commerce, 1965). Although shareholders are explicitly given the right to vote and participate in the general assembly of the company, some practical restrictions are placed on the voting exercise. Shareholders are entitled to attend the general assembly personally or by proxy. Voting by mail or electronically is not allowed or not practised and in some cases, shares must be blocked before the meeting. With the development of the central depository, international standards suggest that procedures should not make it unduly difficult or expensive to cast votes.

Article 94 states that every shareholder has the right to participate in the discussion in general meetings and could ask questions of board members and any company law which prevents shareholders exercising this right is invalid. However, shareholder participation is usually weak (Ministry of Commerce, 1965). This could be attributed to the lack of culture, poor awareness among small investors, and the speculative nature of stock trading. The consequences of this situation are unfavorable qualitative and quantitative participation of shareholders in the decision making process. The power is dominated by controlling shareholders. Controlling shareholders are individuals, institutions, or families. A single family may have controlling stakes over a number of companies either directly or indirectly. They have strong incentives to monitor the company and its management and can have a positive impact on the governance of the company. However, their interests may also conflict with the interests of minority shareholders. The conflict is evident when controlling shareholders abuse the company's resources for private benefits.

While each shareholder has the right to vote (one share one vote), he or she has the right to file a complaint with the regulating agency regarding the violation of the Company Law. Article 109 states that shareholders representing at least 5 per cent of the capital have the right to complain to the Ministry of Commerce and ask for inspection on the company if they are worried. Articles 109 and 78 indicate that minority shareholders are protected by the courts as they can request the nullification of a resolution issued for the benefit of a certain category of shareholders, causing harm to the minority shareholders, or bringing special benefit to the board of directors (Ministry of Commerce, 1965).

There are no limits on Saudi citizens trading shares of Saudi joint stock companies. The Gulf Cooperation Council[5] (GCC) citizens are allowed to invest in certain companies and within limited percentages according to a decision of the GCC. Non-GCC nationals are not allowed to invest directly in Saudi companies except through closed investment funds. The purpose of this procedure is to open the market gradually to attract foreign investment and acquaint foreign investors with the local economy.

[5] Saudi Arabia, Bahrain, Kuwait, Oman, Qatar and the United Arab Emirates

3.5.2. Board of Directors of Joint Stock Companies in Saudi Arabian

In the absence of adequate empirical evidence, the author will attempt to shed light on the nature of the board of directors in Saudi Arabia by analyzing the Board of directors in all listed Saudi corporations. The management of the joint stock companies in Saudi Arabia is composed of a board of directors. This board, appointed by the shareholders, must have a minimum of three members. Directors must own at least 200 shares of the company.

The Board of directors in Saudi Arabia has been given considerable responsibility to ensure the effectiveness of corporate governance in the Saudi Arabian corporations. This authority and responsibility has been legislated by the Royal decree No. 6 of 1385H (1965) and is contained in the Companies Law (1965) articles 66 to 82. Hence, the board of directors in Saudi Arabia has a legally defined role in the overall corporate governance system in the Saudi joint stock companies. Consequently, the use of an audit committee as a committee reporting to the board is not new in Saudi Arabia and some corporations already have an audit committee as a regular feature of their corporate control structure. They serve as a committee reporting to the board of directors and perform so as to make the board more effective and more professionally accountable to depositors, investors, shareholders and regulators.

The duties and powers of directors of the Saudi joint stock companies are both statutory and contractual in nature. They are conferred by the Saudi Arabian Companies Law and the company's constitutional documents. Additional directors' duties are also set down in specific legislation such as the Banking Control Law, the Commercial Registration Law, the Commercial Information Law and the Commercial Fraud Law.

Saudi Arabia has placed particular emphasis on the issue of corporate governance. Hence the Saudi Companies Law issued in 1965, includes a number of Articles that organize the operations of commercial companies and the relation between the concerned parties through identifying the relationship between the board of directors, the companies' executive management and the shareholders.

The following Articles have been translated from Chapter Three, entitled "Managing Joint Stock Companies", section one, entitled "Board of Directors", of the Saudi Companies Law (Ministry of Commerce, 1965), which govern boards of directors in Saudi Arabia.

- Article 66 of the Companies Law stated that a joint stock company must be managed by a board of directors. Board members of a joint stock company must be three and more. Ordinary general meetings have rights of appointing, reappointing and dismissing board members.
- Article 68 - A director must hold shares in the company of not less than SR10,000 (US$2667) in value. The shares must be deposited in one of the banks designated by the Minister of Commerce within 30 days of the director's appointment. The shares are non-transferable until the lapse of the time prescribed for the hearing of any liability suit against the director, or until a judgment is entered in a liability suit.
- Article 69 - A director must not have any direct or indirect personal interest in any business or contract carried out on the company's account, unless he holds a permit from the ordinary general meeting to do so. This permit must be renewed every year although transactions by a director which were subject to a public bid, where the director makes the best bid, are excluded.
- Article 72 - A director must not divulge to the shareholders or others, other than at the ordinary general meeting, any of the company's secrets which came to their knowledge through their role as a director.
- Article 74 - Companies must clarify the directors' compensations which could be monetary, physical, percentage of dividend (not more than 10% of net dividends)
- Article 74 – Also states that the directors' report to the ordinary general meeting must give a comprehensive statement of all fees, dividends, expenses and/or other advantages obtained by the directors during the fiscal year.
- Article 76 - The directors shall be jointly liable to pay damages sustained by the company if the company's articles of association or any amendments to them are not published correctly.
- Articles 229 and 230 - There are certain penalties of the Companies Law which a director may be liable for in respect of non-compliance with the Companies Law. These penalties are without prejudice to the requirements of Islamic law and its

relevant penalties. The Companies Law penalties include imprisonment for a term between three months and one year, and a fine between SR1,000 (US$267) and SR20,000 (US$5,334), depending on the nature of the non-compliance or contravention.

Separation of ownership and control in Saudi Arabia, however, has not yet been fully realized. After the recent international corporate crises, experts in the developed countries recommended the separation between the Chief Executive Officer (CEO) and the duties of the Chairman of the board. While this recommendation may be acceptable, it would be difficult to have it adapted in Saudi Arabia, as the majority of companies are family-owned. Although the Saudi Companies Law, specifically Article 66, specified the minimum required number of non-executive directors, it does not provide for the separation of the roles of the chairman of the board from those of the general manager (Ministry of Commerce, 1965). The existence of three non-executive board members was considered sufficient to exercise independent judgment and avoid conflict of interest. Experience, however, indicates that despite the existence of non-executive members, their role in this regard is not practised. In many cases, the controlling shareholders are in a position to choose all board members. Consequently, the assigned persons are either inexperienced in the field of activity of the company or in financial matters, or are in close relationship with executive board members or the Chairman, and may feel obligated to act in the interest of the controlling shareholders.

3.5.3. Audit Committee and Internal Audit in Saudi Arabia

The resolution of the Minister of Commerce No. 422, issued in 1388H (1968), specified certain requirements that should be complied with in order to practise auditing in Saudi Arabia (Ministry of Commerce). This resolution was in force until issuing the CPA Regulations in 1395H (1974), which was the first foundation stone laid to organize the profession in the Kingdom. A higher committee for certified public accounting was established, in accordance with the Regulation, to supervise and monitor the profession (SOCPA). Serious steps were then taken to promote the accountancy and auditing professions in Saudi Arabia.

Recognising the importance of audit committees as a major tool to increase confidence in financial statements the Minister of Commerce issued a resolution in January 1994, mandating all public companies to establish audit committees (SOCPA). In 2003, the Saudi Organisation of Certified Public Accountants (SOCPA, 2003) regulated the establishment of audit committees in Saudi Arabia and regulated what is required from the audit committees' members. The SOCPA (2003) regulations and guidelines are summarized as follows.

- Audit committee must be at least four members. A maximum number of two members could be elected from the non-executive board members.
- Audit committee member:
  - must be a shareholder holding at least 100 shares and not more than 5 per cent of the company's shares.
  - must be qualified and have knowledge of accounting and financial matters as well as the company's business. One of the members must:
    - hold a PhD in accounting with at least two-year experience in the accounting and auditing field; could be reduced to one year if he has the Saudi CPA; or
    - hold a master in accounting with at least four-year experience in the accounting and auditing field; could be reduced to three years if he has the Saudi CPA; or
    - hold a bachelor in accounting with at least seven-year experience in the accounting and auditing field; could be reduced to six years if he has the Saudi CPA.
  - must not be an executive board member of the company or its branches.
  - must not be a member of any other committee in the company which is assigned by the board of directors.
  - must be independent. A member is independent if:
    - he has no direct or indirect interest in the company's transactions and/or contracts;
    - he has no direct financial benefits with the executive board members or their wives;
    - he has no personal relationship with the executive board members; and

- he is not a member of more than one committee in the same industry at the same time.

- Each audit committee member must provide the board of directors with a nomination of the eligible board members with the CV for each person nominated. The board of directors, then, choose from those nominated by the audit committee members.

Section 7 of the Regulation stated that the committee must meet every three months at least (four meetings a year). It also stated that the audit committee must meet with the external auditor, the chief executive officer, the board of directors and the internal auditor at least once a year (SOCPA, 2003).

The audit committee should also nominate five audit firms (external auditors) from those licensed by the Saudi Ministry of Commerce. The nominated audit firms are then asked to submit proposals to the company. The audit committee, then, recommends one or more firm/s as appropriate. The recommendation will then be taken, by the directors, to the general meeting, which has the ultimate responsibility for appointing the external auditor, determining the audit fee and the tenure of office. Subject to the requirements in the resolution, if only one audit firm is appointed, then the audit committee does not recommence the nomination process until three years after the audit firm commenced the audit. When more than one audit firm is appointed, the nomination process does not recommence until five years after the audit firms commenced their audit (Ministry of Commerce, 1994).

With regard to internal audit in Saudi Arabia, Al-Twaijry et al (2003) held some interviews in 1998 with academics and external and internal auditors to examine the effectiveness of the internal audit in the Saudi Arabian corporate sector. The result showed that the internal audit in the Saudi corporations "was not well developed" (Al-Twaijry et al., 2003: p.507). Al-Twaijry et al. (2003: p. 507) stated:

> The results show that internal audit is not well developed. Where it does exist it operates in departments that are inadequately resourced, lack qualified staff, have restrictions on their degree of independence, concentrate on compliance audit rather than performance audit and where internal auditors are not accepted by management and auditees.

Al-Twaijry's interviewees expressed concerns about the terms of reference of audit committees and the scope of work undertaken. The independence and expertise of audit committee members were called into question. The interviewees were of the opinion that there was a clear need for the Ministry of Commerce to issue further regulations in order to improve the effectiveness of audit committees in Saudi corporations. However, the members of audit committees have not participated in these interviews.

3.5.4. Disclosure and Transparency in Saudi Arabia

Listed companies on the Saudi Stock Exchange (Tadawul) are required to disclose financial, non-financial and operational performance on continuous and regular quarterly, semi-annual and annual bases. Article 89 of the Saudi Companies Law emphasizes that the board of directors must prepare mandatory information including: balance sheets, income and cash flow statements, directors' reports, changes in stockholder equity and board composition, as well as the external auditors report (Ministry of Commerce, 1965). These statements must be prepared no more than sixty days before the annual general meetings. The board's chair must sign all statements and keep copies in the main branch of the company so that they could be available to shareholders at least twenty-five days before the general meeting. Compliance with these requirements is monitored and enforced by the capital market regulating agencies as well as the Saudi Stock Exchanges. Non-compliance with these legal requirements is subject to sanctions. Article 89 also states that the board of directors must publish the abovementioned statements in a Saudi newspaper (Ministry of Commerce, 1965).

Joint stock companies in Saudi Arabia circulate information about themselves through their published annual reports. Abu Baker and Naser (2000) argued that the annual report is viewed as the main source of corporate information in developing countries and it is used by companies as a medium to disseminate information to exteral interested parties. Given that the report contains information on a firm's profitability and liquidity, it is expected to help investors, creditors and other users make informed decisions about the company. Unlike companies operating in the developed world, the annual report published by a Saudi company represents the only source of financial information available to users from the company.

The role of the accounting and auditing profession is the key to the application of corporate governance principles with regard to disclosure and transparency and is the key to a stronger legal environment within the corporate sector. Saudi Arabia as well as other countries in the region has not managed to establish a supervisory body that would ensure auditor independence and sound and fair practices of corporate governance. At present, supervision is thin and scattered among many agencies without formal mechanisms of coordination and consistency.

It is common practice for the company statutes to determine what level of disclosure relating to the board should be disclosed to shareholders at the assembly meeting. The disclosure of the names of directors and their remuneration is required. Article 74 of the Saudi Companies Law states that companies must clarify the board of directors' remuneration method in the general meeting. This remuneration could be a salary, bonus or percentage of revenues (must not exceed 10 per cent of net revenues) and it could be a combination (Ministry of Commerce, 1965).

3.6. ISLAM AND CORPORATE GOVERNANCE

Islam literally means 'peace' and 'obedience', and adherents to Islam have to be 'obedient' to God and to appreciate the purpose of their existence in this world (Al Faruqi, 1992). God is said to have proclaimed that, *"I have only created... men that they may serve me"* (*al-Qur'an*, 51:56). The nature of this service is taken to have been spelled out clearly when God, upon creating men, declared, *"I will create a vicegerent on earth"* (*al-Qur'an*, 2:30). Muslims consider humans to be vicegerents (successor) of God. Thus, whatever worldly possession a Muslim has is to be held in a stewardship capacity – that is simply in trust from God (Abu-Sulayman, 1994). According to Islam, Muslims are trustees (or stewards) for God: Man therefore agrees to assume this great responsibility in a covenant with God (Abdul Rahman, 2003).

The influence of religion upon corporate governance is not an issue that has been explored to a great extent in the literature, although it is easy to see how the two might be connected. Traditionally, religion has had a role in shaping and enforcing ethical behaviour such as truthfulness, honesty and justice. A community in which such values are paramount may be marked by a high degree of trust in business dealings and financial affairs. More generally, following Gray (1988) and Perera (1989), culture has been recognised as a likely determinant of corporate governance, since culture – defined by Hofstede (1994: 180) as the collective programming of the mind which distinguishes the members of one group from another – governs how individuals perceive their responsibilities and carry out their duties. If culture influences corporate governance then so surely does religion, if only because religion affects cultural values (Hamid et al., 1993).

Since the Kingdom of Saudi Arabia is the heartland of Islam, the birth place of its history and the site of the two holy mosques and the focus of Islamic devotion and prayer, it is essential, when studying corporate governance in Saudi Arabia, to determine and investigate the effects of Islam upon corporate governance. Saudi Arabia is committed to preserving the Islamic tradition in all areas of government and society. Islam guides not only the lives of the people, but also the policies and functions of the government, which, in turn, regulate and impose corporate governance. The Holy Qur'an is the constitution of the Kingdom and *Shari'ah* (Islamic law) is the basis of the Saudi legal system. Saudi Arabia is a leader in the pursuit of world-wide Islamic solidarity. It hosts the Muslim World League and the Organization of the Islamic Conference, institutions dedicated to preserving Islamic interests. In many respects, the Kingdom has been responsive to the needs of the Islamic world. Saudi Arabia contributes generously to the Islamic Development Fund, which provides assistance for community infrastructure projects; to the Islamic Development Bank, headquartered in Jeddah, and to the Islamic Organization for Science, Technology and Development.

The government laws and regulations in Saudi Arabia must be submissive to the *Shari'ah* (Islamic laws). Chapter I, Article 1 of the Saudi Basic Law explicitly provides that Saudi Arabia's only "constitutions" are the Qur'an and the Sunnah (the teachings and deeds of the Prophet Muhammad).

Two aspects, in particular, shape the relationship between Islam and corporate governance. One is the Islamic law, *the shari'ah*, and the other is the Islamic jurisprudence, *the fiqh*.

3.6.1. Islamic Law (the Shari`ah)

The Islamic Law (shari`ah) refers to the laws and way of life prescribed by Allah (God) for his servants. The shari`ah deals with the ideology and faith; behaviour and manners; and practical daily matters. "To each among you, we have prescribed a law and a clear way," (Qur 'an 5:48). Shari`ah includes the Qur'an and the Sunnah of the Prophet Mohammed. The Qur'an is the direct word of Allah, and is the first most important source of guidance and rulings. The Sunnah of the Prophet Mohammed is the second source of guidance and rulings. The Sunnah is an inspiration from Allah, but relayed to us through the words and actions of the Prophet, and his concurrence with others' actions. The Sunnah confirmed the rulings of the Qur'an; detailed some of the concepts, laws and practical matters which are briefly stated in the Qur'an; and gave some rulings regarding matters not explicitly stated in the Qur'an (Foundation for Islamic Knowledge).

The shari`ah claims to regulate all aspects of life, ethical and social, and to encompass criminal as well as civil jurisdiction. Every act of believers must conform to Islamic law and observe ethical standards derived from Islamic principles. Corporate governance practices must be in accordance with the rules and regulations of Islam.

3.6.2. Islamic Jurisprudence (the Fiqh)

Islamic jurisprudence (the fiqh) means knowledge, understanding and comprehension. It refers to the legal rulings of the Muslim scholars, based on their knowledge of the shari`ah; and as such is the third source of rulings. The science of fiqh started in the second century after Hijrah[6], when the Islamic state expanded and faced several issues which were not explicitly covered in the Qur'an and Sunnah of the Prophet. Rulings based on the unanimity of Muslim scholars and direct analogy are binding. The four *Sunni* schools of thought, *Hanafi, Maliki, Shafi'i and Hanbali*, are identical in approximately 75% of their legal conclusions. Variances in the remaining questions are traceable to methodological differences in understanding or

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[6] Hijrah is an Arabic calendar which starts from the immigration of the Prophet Mohammed from Makkah to Al-Madinah.

authentication of the primary textual evidence. Differing viewpoints sometimes exist even within a single school of thought.

3.6.3. How do the Shari`ah and the Fiqh Govern Corporate Governance Practices and Polices?

Corporate governance practices and polices in Saudi Arabia must be based on the Islamic faith and must stay within the limits of the shari`ah and the fiqh in all of its actions and deeds. The shari`ah emphasizes that corporate governance should be value orientated and promote fairness and justice with respect to all stakeholders of a company. Those stakeholders who receive the most attention paid money to invest and share the corporation's profits and losses. Western corporate governance structures are quite different from these under Islamic joint stock companies because the corporations must obey a different set of rules - those of the *Holy Qur'an* - and meet the expectations of the Muslim community by providing Islamically acceptable operating modes. Corporate governance as a set of relationships between a company's management, its board, its shareholders and other stakeholders can be seen as an internal interaction process which is externally governed by the shari`ah and fiqh on the one side and the market system on the other side.

Many verses in the Holy Qur'an regulate corporate governance, and the attitude of Islam is that there should be no impediment to honest and legitimate trade and business, so that people earn a living, support their families and give charity to those less fortunate. Trading and investment can only be undertaken in activities which are not prohibited in Islam (prohibitions include gambling, alcohol, pornography, manipulation and anything which is harmful to society).

In a Muslim society like Saudi Arabia, the development of corporate governance should be based on the provisions of the Islamic shari`ah and the fiqh along with other necessary principles and postulates which are not in conflict with the shari`ah and fiqh. Two approaches have been suggested by several authors to develop Islamic corporate governance (Karim, 1999; Adnan and Gaffikin, 1997; Askary and Clarke, 1997; Alam, 1997; Baydoun and Willett, 1997; Lewis, 2001; and the Accounting and Auditing Organization for Islamic Financial Institutions, 2003). The two approaches are:

a. establish corporate governance based on the spirit of Islam and its teaching, and then consider the established corporate governance in relation to contemporary corporate governance thought; and
b. start with corporate governance established in contemporary corporate governance thought, test them against Islamic shari`ah, accept those that are consistent with shari`ah and reject those that are not.

Baydoun and Willet (1997) argued that there are at least four objectives of accounting disclosure for an Islamic firm, whereby the first two are specific requirements laid down by shari`ah for the firm to avoid *riba* (usury) and pay *zakat* (the religious levy). The second two objectives are based on inferred general requirements which can be referred to as 'social accountability' and 'full disclosure'. According to Baydoun and Willett (1997), full disclosure does not mean to disclose everything down to every minute detail of transactions. There is, however, the need for the preparer of accounts to disclose everything that is believed to be important to users for purposes of serving God. In a more precise word, the Accounting and Auditing Organization for Islamic Financial Institutions' Statement of Financial Accounting No. 2 on Concepts of Financial Accounting for Islamic Banks and Financial Institutions (SFA 2) made it very clear that the Islamic concept of disclosure revolved around the concept of 'adequate' disclosure. Here, adequate disclosure means that the financial statements should contain all material information necessary to make them useful to users (Abdul Rahman, 2003).

Corporate governance operates to discharge the accountability of enterprises as a result of separation of ownership and the management. The users might be shareholders, creditors, potential investors and the public. In the Muslim society, the concept of accountability is ingrained in the basic creation of man as a vicegerent (successor) of God on the earth. Man's mission on earth is to fulfill the purpose of its existence in the universe. Man is thus created as trustees and accountable for all their actions (Abu-Sulayman, 1994; Abdul Rahman, 2003).

Boards of Directors in Islam are not merely responsible to human superiors, the management, shareholders and stakeholders. He/She is a servant and trustee of God in all situations, is simultaneously responsible to God the Owner of his very self and the resources he is utilizing and managing. To forget or to neglect this fundamental aspect of this responsibility is tantamount to a betrayal of divine trust with all the attending consequences in this world and in the next (Hassan, 1995).

Certain Islamic economic and financial principles have an impact upon corporate governance practices and policies. These principles include, most importantly, the institution of *zakat*[7] (the religious levy), and the prohibition of *riba* (usury), the institution of an interest free economic system, the prohibition of *haram* (forbidden: business, food, relationship, etc.) and institution of *halal* (lawful: business, food, relationship, etc.), the prohibition of *gharar* (e.g., undertake a venture blindly without sufficient knowledge or to undertake an excessively risky transaction) and others.

According to Beheshti (1992, 126) the *Shari'ah* calls for fair and free trading, fully complying with principles. Baydoun and Willett (1997, 12-19) argued that the accounting implications of the shari'ah includes four titles: the need to properly compute zakat, the prohibition of interest, the concept of social accountability and the concept of full disclosure. The board accountability and decision usefulness contexts have been used for the development of boards of directors and disclosure and transparency from an Islamic view meant to provide information for prohibition of interest in the firms. The principle of social accountability and justice is embodied in Islam by the elements and guarantees which Islam provided for the system of the distribution of wealth in Islamic society. *Zakat* (levy), *Riba* (usury), *haram* (forbidden activities), *halal* (permissible activities), *gharar* (trading in risk) are the original tools to carry out social justice in society.

Zakat is the amount of money that every adult, mentally stable, free, and financially able Muslim, male and female, has to pay to support specific categories-people. Every Saudi joint stock company[8] has to establish a Zakat fund for collecting the tax and distributing it exclusively to the poor directly or through other religious institutions.

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[7] *Zakat* is a form of religious tithe paid annually by Saudi and GCC companies and individuals engaged in trade in the Kingdom. The *Zakat* on trade activities is 2.5 percent on taxable capital.

[8] A company is considered resident in Saudi Arabia if the company is registered in Saudi Arabia, if its administrative office or factory is in Saudi Arabia or if it is performing contracts or work in Saudi Arabia.

Disclosure in financial statements of Islamic firms is to be guided by several considerations. The use of historical cost for asset valuation satisfies the stewardship objective. On the other hand, for calculating and paying *zakat*, the use of market selling prices would be appropriate. There has to be a distinction made between *halal* and *haram* transactions and how the profits from the latter have been utilitized (for example, money given to charity). There has to be substantial additional disclosure about the social performance of the firm's operations, including the allocation to and utilization of funds for *zakat*.

Shareholders must comply with the Shari'ah principles in their trading activities. To comply with Islamic Shari'ah, share investing, for example, should be restricted to common stocks. Investment in preferred stocks is prohibited in Islam as preferred stocks guarantee the amounts paid out to investors in the form of dividends. Such a predetermined and guaranteed rate of return is prohibited for the reason that it may be classified as *riba* (usury). Thus, while an investor may share the risks of ownership with other investors, the preferred status of the preferred stock means that there is extra compensation for the owner for which the owner has not had to pay. In some cases, however, preferred stock may be offered without a fixed dividend or without a dividend at all. Even so, it is the right of the shareholders to change those terms through a vote at their shareholders' meetings. Thus, while a Muslim investor may purchase such stock, he/she may hold it only for as long as it carries no fixed dividend. If the status of the stock changes as a result of a vote, the Muslim investor will have to liquidate his/her interest in the company immediately. And if a fixed-amount dividend is received before the stock can be sold, the entire amount of the dividend will have to be given away as charity.

The use of interest-bearing bonds is also prohibited and so would the use of interest in leasing transactions, notes receivable and notes payable. In other words, firm managers cannot enter into contractual relationships involving *riba*. Shareholders must invest only in companies that meet the following criteria (Muslim Investor, 2005).

- companies that have a debt to equity ratio equal to or less than 33%;
- companies that have Account Receivables to Total Asset ratio equal to or less than 47%;

- companies that do not receive more than 9% of total income from non-operating Interest activities.

How can Islamic banks survive and prosper when they are not allowed to charge interest? This is certainly the question that faces a lot of non-Muslim economists. The answer is that there are many Islamic versions and alternatives to the *Riba* in Islamic banking with equal profit. The *Murabaha* (cost-plus financing) is one of the alternatives for a just monetary system. Murabaha is a cost-plus contract in which a client, wishing to purchase equipment or goods, requests the Islamic bank to purchase the items and sell them to him at a cost plus declared profit. By this technique a party needing finance to purchase certain goods gets the necessary finance on a deferred payment basis. The finance provider does the purchasing of the required goods and sells them on the basis of a fixed mark-up profit, agreeing to defer the receipt of the value of the goods even though the goods can be delivered immediately. The need for finance of the one in need is thus met. This financing technique is sometimes considered to be the same as interest, however, in theory, the mark-up is not in the nature of a compensation for the time or deferred payment, even though the entire cost had to be incurred because the needy person did not have at hand to make the purchase he wanted. Rather, the mark-up is for the service that the finance-owner provides, namely, seeking out and locating and purchasing the required goods at the best price.

Islam has an effect on auditing too. Auditors must monitor performance so that the company operates as a strictly Islamic concern. The Shari'ah highlights the differences between Islamic and Western business practices. Based on man's contract with *Allah*, which is to adhere to the Shari'ah, types of business activities are constrained to only those that are *halal* (permissible) as mentioned earlier. Involvement in any *haram* (forbidden) activities results in sin. The wisdom behind forbidding certain business activities is that they are harmful and undesirable for human beings and the ecosystem. Avoidance of such activities aids in fulfilling the contract with Allah and society by channeling resources into activities that would bring greatest benefit to society. Hence, choice of business activities must not only be within the boundary of Shari'ah but also influenced by *maslahah* (greatest benefit to society) (Haniffa et al., 2003). The following set of business activities are considered prohibited in Islam, and thus investing in these kind of businesses is not something a Muslim should undertake (Muslim Investor, 2005).

- Food and beverage related (alcoholic beverages, pork and pork products, tobacco products, etc.).
- Gambling (casinos, Internet gambling outfits, betting, lottery, etc.).
- Pornography and adult-orientated material.
- Interest and businesses based mainly on interest.
- Illegal activities (prostitution, drugs, etc.).
- Other activities (margin trading, shorting, etc.).

Islam recognises corporate governance not only as a lawful profession but also as a moral duty. Islam has laid down a complete set of rules for corporate governance. The reason for these rules is to specify what halal earning is. There are many traditions (Ahaadith) concerning halal provision that can also be found in the books containing the traditions of the Prophet Mohammed (peace be upon him). Actually, Islam has encouraged men to earn their own provision and to provide for their families. The condition is that the earning has to be according to the conditions set by the Shari'ah. Any sort of transaction that does not correspond to the rules of trade will not be allowed. These rules can be found under the heading of trade in the books of jurisprudence. Interest is amongst those conditions from which all dealings must be free.

3.7. SUMMARY

In this chapter, an attempt has been made to investigate the Saudi history, constitution, legislation, culture, economy, capital market, regulatory authority and religion to come up with a clear vision of "corporate governance in Saudi Arabia," which is the title of this chapter.

It has been said that the Basic Law adopted in 1992 declared that Saudi Arabia is a monarchy ruled by the sons and grandsons of King Abdul Aziz Al Saud, and that the Holy Qur'an is the constitution of the country, which is governed on the basis of Islamic law (Shari'ah) and on decrees promulgated by the Council of Ministers. Saudi Arabia has the world's largest oil reserves, 25 per cent of the world's total. Saudi

Arabia's huge oil reserves and mineral resources, expanding domestic market, liberal labour policies, increasing privatization and generous packages of investment incentives make it one of the best investment locations in the Middle East.

Corporate governance practices in Saudi Arabia are governed by four bodies: the Ministry of Commerce, the Saudi Arabian Monetary Agency (SAMA), the Saudi Stock Exchange (Tadawul) and some professional bodies such as the Saudi Accounting Association and the Saudi Organization for Certified Public Accountants. Each regulatory body of these four bodies was investigated.

The assessment of corporate governance is the outcome of the assessments of the four corporate governance mechanisms, namely: shareholder rights; board of directors and outside directors; audit committee and internal audit; and disclosure and transparency.

Given that the influence of Islam upon corporate governance is not an issue that has been explored to a great extent in the literature, although it is easy to see how the two might be connected, the last section contains a clarification of how Islam is expected to effect corporate governance. Two aspects, in particular, were argued to shape the relationship between Islam and corporate governance. One is Islamic law, *the shari'ah*, and the other is Islamic jurisprudence, *the fiqh*. Corporate governance practices and polices in Saudi Arabia must be based on the Islamic faith and must stay within the limits of the shari`ah and the fiqh in all of its actions and deeds. Many verses in the Holy Qur'an regulate corporate governance, and the attitude of Islam is that there should be no impediment to honest and legitimate trade and business. Certain Islamic economic and financial principles, *Zakat*, *Riba*, *haram*, *halal*, *gharar*, which have an impact upon corporate governance practices and policies were discussed.

CHAPTER FOUR:

MECHANISIMS FOR EFFECTIVE CORPORATE GOVERNANCE IN SAUDI ARABIA

4.1. INTRODUCTION

In recent years, pushing for higher corporate governance standards has become a regular campaign with the participation of an increasing number of parties: academics, media, regulatory authorities, corporations, institutional investors, international organizations, shareholder rights watchdogs, etc. Numerous initiatives have been proposed by developed and developing countries to enhance their corporate governance practice (e.g., new listing/disclosure rules, mandatory training for board directors, enforced codes of governance, etc).

For capital markets to function efficiently and effectively, participants must have confidence in the corporate governance system. The corporate failures of recent times, Enron Corp., WorldCom, HIH and others, raised concerns about the lack of vigilant oversight and the lack of corporate governance systems in those organizations. These failures are serious threats to the confidence of investors.

Effective corporate governance systems can be achieved when there are well-balanced, functioning mechanisms of corporate governance. Corporate governance is a mechanism of managing, directing and monitoring a corporation with the goal of creating shareholder value while protecting the interests of other stakeholders.

In this chapter, a "four-legged chair" model that supports responsible, reliable, fair, accountable and transparent corporate governance systems is developed. Shareholders, board of directors, audit committees and disclosure and transparency are the four legs of the chair, supporting the one top goal of producing an effective corporate governance system in a firm. The model is based on the active participation of all parties and fosters continuous improvements.

Therefore, the model (chair) consists of four participants (legs):

- shareholder rights;
- board of directors;
- audit committees; and
- disclosure and transparency.

The report of the Blue Ribbon Committee (1999) on "Improving the Effectiveness of Corporate Audit Committee" suggested a "three-legged stool" involving the chief financial officer, independent auditor and audit committee. Now, however, more emphasis is being placed on the entire corporate governance responsibility.

4.2. FOUR MECHANISIMS FOR EFFECTIVE CORPORATE GOVERNANCE IN SAUDI ARABIA

Corporate governance emphasizes the values of fairness, accountability, transparency and responsibility, and it involves a set of relationships between a company's management, its board, its shareholders and other stakeholders. Effective corporate governance revolves around strong, active and independent boards of directors; laws and regulations that guarantee shareholder rights; and the presence of accepted standards of financial accountability and transparency within firms. Sound corporate governance principles can create safeguards against corruption and mismanagement, while promoting democracy and transparency in economic life.

A number of multilateral organizations (e.g., the United Nations Development Programme 'UNDP'; the Organisation for Economic Cooperation and Development 'OECD'; the World Bank; the International Monetary Funds 'IMF'; the International Corporate Governance Network 'ICGN'; and others) have reflected on the elements of "good governance", and on their relationship to development. As the experiences of these organizations vary, their perceptions of what constitutes good governance vary, too.

The Business Sector Advisory Group on Corporate Governance to the Organization for Economic Cooperation and Development (OECD) in 1999 articulated a set of core principles of corporate governance practices that are relevant across a range of jurisdictions. These principles are:

- fairness, referring to the equitable treatment of all shareholders;
- transparency, i.e., the process of disclosing information on a company's performance over a certain period of time;
- accountability based on a system of checks and balances and sound auditing practices; and
- responsibility for decisions and actions through clearly defined roles and duties for owners, shareholders, directors and managers.

The World Bank's interest in governance stems from its concern with the effectiveness of the development efforts it supports. From this perspective, sound corporate governance, in the broadest sense of the phrase, is critical so that firms ensure adequate returns and efficacy of projects financed and for the World Bank's underlying objectives of helping countries reduce poverty and promoting sustainable growth. Hence, the World Bank's emphasis in recent years has shifted from its own interventions to the overall country context within which those interventions take place. In doing so, it has been guided by the nature of its operations and the opportunities for action that these offer. Accordingly, the key dimensions of governance identified by the World Bank are: (i) private sector management; (ii) accountability; (iii) legal framework for development; and (iv) transparency and information (ADB, 1995).

Accordingly, the researcher is concerned directly with the manner in which joint stock corporations are managed in Saudi Arabia, and with the legal framework for corporate governance development. However, in formulating an analytical framework for addressing governance issues, a distinction between elements of good governance is drawn. The specific areas of action (e.g., private sector) in which they could be promoted or their existence enhanced is also considered. In line with this reasoning, and building upon the approach of the multilateral organizations, four basic elements of effective governance have been identified:

a. shareholders' rights;
b. board of directors;
c. audit committee and internal audit; and
d. disclosure and transparency.

4.2.A. Shareholders' Rights

The first basic principle of corporate governance relates to shareholders' rights, and their timely access to financial information, voting rights and their involvement in the process and approval of important matters. The OECD (1999, 2004) emphasized the importance of shareholders as an important element of good corporate governance in their definition of corporate governance. The OECD stated:

> (Corporate governance is) a set of relationships between a company's management, its board, its shareholders and other stakeholders. Corporate governance also provides the structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performance are determined. Good corporate governance should provide proper incentives for the board and management to pursue objectives that are in the interests of the company and shareholders and should facilitate effective monitoring, thereby encouraging firms to use resources more efficiently (OECD, 1999: pp.11).

The California Public Employees' Retirement System (CalPERS) quotes the definition of corporate governance from Monks and Minow (2001), believing that it represents the relationship among various participants in determining the direction and performance of corporations, namely: shareholders, management and board of directors.

The Report of the Cadbury Committee on the Financial Aspects of Corporate Governance (1992) clarified the accountability of boards to shareholders. The Report stated:

> The formal relationship between the shareholders and the board of directors is that the shareholders elect the directors, the directors report on their stewardship to the shareholders and the shareholders appoint the auditors to provide an external check on the directors' financial statements. Thus the shareholders as owners of the company elect the directors to run the business on their behalf and hold them accountable for its progress. The issue for corporate governance is how to strengthen the accountability of boards of directors to shareholders (Cadbury Report, 1992: pp. 48).

In Saudi Arabia, over 2.4 million individuals have invested in shares of Saudi Arabian joint stock companies (Al-Jasser, 2002). Despite the huge economic base of the oil-rich kingdom, the stock market in Saudi has so far been limited to a small number of dealers as the overwhelming majority of stocks is concentrated in the hands of the government and business families (Khayyat, 2003). Only 71 firms are listed on the bourse, which economists say has a capacity for more than 200 firms. During the last decade, only 13 new companies were admitted to the market (Tadawul, 2005).

The Saudi Arabian government has privatized state-owned assets very quickly in the last few years and allocated considerable amounts of shares to the public. While the Saudi privatization procedure led to very fast privatization, it also frequently resulted in dispersed ownership of shares. Since the owners of small share packages have little incentive to collect costly information to monitor management, many firms are essentially controlled by management which, in turn, increases the agency problems. The creators of the privatization process were hoping that this problem would be mitigated over time. By selling state-owned shares directly to outside blockholders, the power of management would be curbed. However, in practice, the role of outside blockholders has been restricted by the fact that management can choose not to honour shareholder rights of outside shareholders due to weak enforcement of the laws concerned (Willer, 1997).

Therefore, it seems necessary to analyze the issue of shareholder rights in Saudi Arabia. La Porta et al. (1996) examined the relationship between protection of investors and the financing patterns observed over a variety of countries. Their main findings suggested that concentrated ownership could act as a substitute for strong legal protection of outside shareholders' interests. However, their paper says little about how this equilibrium outcome is to be reached.

In this respect, the case of Saudi Arabia is an interesting natural experiment, where directly after the privatization process there were neither strong laws of corporate governance nor concentrated ownership.

It is worth noting that these problems are not specific to Saudi Arabia. The 1995 International Finance Corporation (IFC) Factbook of Emerging Markets lists only 5 out of the 26 emerging markets it covers as having investor protection of an internationally acceptable quality. It also singles out the Chinese equity market as having especially poor investor protection. While this study focuses on Saudi Arabia in its empirical investigation, Saudi Arabia had not been included in the last IFC ranking, the findings will be relevant to other Islamic emerging markets as well.

The importance of investigating shareholder protection in a developing market like Saudi Arabia comes from the following reasons. First, studies of emerging markets more clearly reveal the importance of shareholders rights in corporate governance (Lins, 2000) even though emerging markets generally suffer from a lack of shareholder and creditor protection and have poorly developed legal systems (La Porta et al., 1998). Second, governance theories about ownership concentration, which implicitly rely on shareholder protection, may not be appropriate in this setting. As such, it is an open question whether evidence on shareholder rights from studies of firms in other contexts, or countries, will hold true in emerging markets such as Saudi Arabia. Moreover, the potential impact of governance improvement in emerging markets is substantial. It is assumed that poor corporate governance bears much of the blame for the relatively poor terms on which entrepreneurs can obtain external capital in emerging markets. Corporate governance evidence specific to emerging markets should, therefore, be of benefit to policy makers, practitioners and academics on how to improve their governance structures in order to be able to draw international investors and quality issuers.

Shareholders and investors do care about the corporate governance system in a firm. It is generally recognized that shareholders and investors, both foreign and domestic, consider the quality of corporate governance when making investment decisions about a specific country and/or a specific company (Weil, Gothshal and Manges, 2002). Giannetti and Simonov (2003) analysed whether investors take into account corporate governance when they select stocks. The authors found that all categories of investors who generally enjoy only security benefits (domestic and foreign; institutional and small individual investors) are reluctant to invest in companies with bad corporate governance. In contrast, individuals who have strong connections with the local financial community because they are board members or hold large blocks of at least some listed companies behave differently. They also found that the effects of corporate governance on portfolio decisions were more pronounced for small and medium-size companies. These findings shed new light on the determinants of investor behaviour and suggest that in order to promote investors it is important to provide them with better protection.

In regards to the first mechanism of corporate governance, which is shareholders' rights, the author is intending to discover the differences between shareholders' rights as defined by some related organisations such as the Organisation for Economic Co-operation and Development (OECD) and their rights in Saudi joint stock corporation and then to discover whether Saudi shareholders "get" their expectations. To ensure shareholders get their rights, key categories were considered such as:

- whether all shareholders are able to exercise their rights; and
- whether all shareholders have equal basic rights (Equitable treatment of shareholders).

4.2.A.1. The Rights of Shareholders

A shareholder can be an individual, a family or family group, a holding company, a bank, an institutional investor (such as a finance company, an insurance company, an investment company, a pension fund, or a mutual fund), or a non-financial corporation (Abdul Samad, 2002).

The Saudi Ministerial Resolve No. 70 has clarified the rights of shareholders to attend general meetings and participate in the discussions, the right to vote and the right to question board members. However, studies have shown that the reality in most general meetings in the public companies in Saudi indicates that minority shareholders are not aware of their rights, do not care about attending general meetings and are not treated in the same way as the majority shareholders (Al-motairy, 2002).

The OECD principles of corporate governance were considered as the benchmarks for best practices in corporate governance to which companies worldwide should aspire. The following have been excerpted from the OECD principles (1999) covering the rights of shareholders:

4.2.A.1.1. The OECD (1999: pp.27-30) Principles of shareholders' rights

The corporate governance framework should protect shareholders' rights.

A. Basic shareholder rights include the right to: 1) secure methods of ownership registration; 2) convey or transfer shares; 3) obtain relevant information on the corporation on a timely and regular basis; 4) participate and vote in general shareholder meetings; 5) elect members of the board; and 6) share in the profits of the corporation.

B. Shareholders have the right to participate in, and to be sufficiently informed on, decisions concerning fundamental corporate changes such as: 1) amendments to the statutes, or articles of incorporation or similar governing documents of the company; 2) the authorisation of additional shares; and 3) extraordinary transactions that in effect result in the sale of the company.

C. Shareholders should have the opportunity to participate effectively and vote in general shareholder meetings and should be informed of the rules, including voting procedures that govern general shareholder meetings:

1. Shareholders should be furnished with sufficient and timely information concerning the date, location and agenda of general meetings, as well as full and timely information regarding the issues to be decided at the meeting.
2. Opportunity should be provided for shareholders to ask questions of the board and to place items on the agenda at general meetings, subject to reasonable limitations.
3. Shareholders should be able to vote in person or in absentia, and equal effect should be given to votes whether cast in person or in absentia.

D. Capital structures and arrangements that enable certain shareholders to obtain a degree of control disproportionate to their equity ownership should be disclosed.

E. Markets for corporate control should be allowed to function in an efficient and transparent manner.

1. The rules and procedures governing the acquisition of corporate control in the capital markets, and extraordinary transactions such as mergers, and sales of substantial portions of corporate assets, should be clearly articulated and disclosed so that investors understand their rights and recourse. Transactions should occur at transparent prices and under fair conditions that protect the rights of all shareholders according to their class.
2. Anti-take-over devices should not be used to shield management from accountability.

F. Shareholders, including institutional investors, should consider the costs and benefits of exercising their voting rights.

Section 'A' can be seen as a statement of the most basic rights of shareholders, which are recognized by law in virtually all OECD member countries. Shareholders' rights to influence the corporation on certain fundamental issues include: the election of board members; or other means of influencing the composition of the board; amendments to the company's organic documents; approval of extraordinary transactions; and other basic issues as specified in company law and internal company statutes. Various jurisdictions also provide for additional rights such as the approval or election of auditors, direct nomination of board members, the ability to pledge shares, the approval of distribution of profits, etc.

The role of shareholders in corporate governance is to monitor and supervise those who direct and control the corporation. The power to direct and control rests with the board, and through it, senior management. Shareholders have no power to interfere in the control and direction of the company. Instead, shareholders monitor and supervise the performance of the board and senior management and exert influence by voting at general meetings, by bringing proceedings directly against the company and by exercising their right to sell their shares (Bird, 2002).

Shareholders should have secure ownership. the right to full disclosure of information, voting rights, participation in decisions concerning fundamental corporate changes such as the sale or modification of corporate assets including mergers and new share issues (OECD, 1999). Markets for corporate control should be efficient and transparent and shareholders should consider the costs and benefits of exercising their voting rights.

Therefore, effective exercise by shareholders of their powers of intervention and control is a very important component of the governance system. It could be concluded that shareholders have the right to: (i) receive a dividend; (ii) transfer ownership; (iii) appoint and remove directors; (iv) appoint and remove auditors; (v) submit resolutions; (vi) be consulted over changes to the memorandum and articles of association; and (vii) be consulted over any changes to the share capital of the company.

Modigliani and Perotti (1996) showed how the development of the equity markets in different countries depends on how well laws protect the property rights of minority shareholders. Furthermore, La Porta et al. (1996, 1998) showed that in countries where legal institutions are under-developed and where the enforcement of laws cannot be relied upon, it is not sufficient to analyze the legal framework when examining whether shareholder rights are protected. Instead, it is necessary to find indicators that reflect the actual behaviour of management towards outside shareholders.

Shares give two different rights to its owners: rights of control and income-rights (Grossman and Hart 1980). Shleifer and Vishny (1997) stated, "Corporate governance deals with the ways in which suppliers of finance to corporations assure themselves of getting a return on their investment," (pp. 737). The quality of corporate governance is defined by Shleifer and Vishny as the degree to which shareholders and other suppliers get a return on their investment. Assuring that shareholders get a fair share of return requires board of directors to be independent and accountable, managers to be responsible, disclosure to be timely and accurate, auditors to be independent and minority shareholders to be protected. If shareholders are not in a position to hold the company accountable, the agency problem occurs. The agency theories argue that the actions of the agents (managers) depart from those required to maximise shareholder returns (Berle and Means 1932). That is, agents will act in their own interest as opposed to that of the principals (shareholders). If agency theory is applied to corporate governance, it is posited that managers will not act to maximise returns to shareholders unless appropriate governance structures are in place.

However, during transition, the more important feature of shares is arguably the control rights. This is true as the majority of privatized enterprises are in need of severe restructuring (Division for Public Economics and Public Administration, 1999). During this period of restructuring, control rights matter even more than during 'normal' times because many long-term, strategic decisions that can involve substantial sunk costs have to be made. Furthermore, the income of firms is in many cases relatively low during transition but is expected to grow fast, such that income rights during the first years are of relatively little importance.

The effectiveness of large shareholdings in the corporate governance system, whereby the equity of an enterprise is concentrated in blocks in the hands of a small number of individuals and institutions, has been the subject of much theoretical and empirical research in the literature. The issue has gained increasing importance in view of some research providing evidence that concentrated ownership of corporations is much more prevalent across countries than is generally believed, and that the Berle and Means (1932) image of the modern corporation being widely held by dispersed shareholders "has begun to show some wear" (La Porta, et al., 1999).

The literature on blockholders focuses on the extent to which these shareholders are in a better position to make the management accountable as opposed to dispersed shareholders (Sarkar et al. 2000). The existing theoretical and empirical literature on the role of block shareholders, however, reveals conflicting predictions and evidence on the role of such shareholders in enhancing corporate value (Shleifer and Vishny, 1997).

The benefits of large shareholding highlighted in the literature may be summarized in terms of the "convergence-of-interest" hypothesis and the "efficient-monitoring" hypothesis (Sarkar et al. 2000). According to these hypotheses, large shareholders are likely to be more efficient than small and dispersed shareholders in monitoring company management since they have substantial investments at stake as well as significant voting power to protect these investments (Berle and Means, 1932; Jensen and Meckling, 1976; Fama and Jensen, 1983; and Shleifer and Vishny, 1986). In addition, large shareholders are likely to mitigate the collective action problem that is present among dispersed shareholders in disciplining inefficient management especially if management stands in the way (Dodd and Warner, 1983), and are also likely to engage in relational investing and be more committed to a company in the long run (Black, 1998; and Blair, 1995).

4.2.A.2. The Equitable Treatment of Shareholders

The legal framework allows for multiple share classes, provided that within a given class shareholders are treated equally and have the same rights. In Saudi Arabia, there are two main classes of shares: ordinary shares and preference shares (Article 103, Saudi Companies Law, 1965). Shareholders in listed companies are usually classified into three categories (see Berle and Means, 1932 and 1968; Farrar, 1987; and Stapledon, 1999): significant shareholders; institutional investors; and individual investors.

The OECD (1999: p. 31-34) stated:

4.2.A.2.1. The equitable treatment of shareholders

The corporate governance framework should ensure the equitable treatment of all shareholders, including minority and foreign shareholders. All shareholders should have the opportunity to obtain effective redress for violation of their rights.

A. All shareholders of the same class should be treated equally.

1. Within any class, all shareholders should have the same voting rights. All investors should be able to obtain information about the voting rights attached to all classes of shares before they purchase. Any changes in voting rights should be subject to shareholder vote.
2. Votes should be cast by custodians or nominees in a manner agreed upon with the beneficial owner of the shares.
3. Processes and procedures for general shareholder meetings should allow for equitable treatment of all shareholders. Company procedures should not make it unduly difficult or expensive to cast votes.

B. Insider trading and abusive self-dealing should be prohibited.

C. Members of the board and managers should be required to disclose any material interests in transactions or matters affecting the corporation.

All shareholders of the same class should be treated equally, including minority and foreign shareholders and should have the opportunity to obtain effective redress for violation of their rights. The OECD (1999, 2004) emphasized the protection of minority and foreign shareholders rights with full disclosure of material information. It ensures the setting up of systems that keep insiders, including managers and directors, from taking advantage of their roles, insider trading is prohibited and members of board and managers should be required to disclose any material interest in transactions.

4.2.B. Board of Directors

Adam Smith (1776) is one of the first authors to address the problem of boards of directors. He stated:

> The directors of (joint stock) companies, however, being the managers rather of other people's money than of their own, it cannot well be expected, that they should watch over it with the same anxious vigilance (as owners) ... Negligence and profusion, therefore, must always prevail, more of less, in the management of the affairs of such a company (Smith, 1776: pp.700).

The Board of directors is an important part of the governance structure (Fama et al. 1983). Aligning the interests of managers and shareholders requires vigilant, independent, effective Boards. A Board of directors may not get involved in day-to-day management, yet it has the unique role of overseeing, monitoring, and controlling management activities. It should monitor management plans, decisions, and activities and act independently. The tone set by the Board usually influences the behaviour of others within the company.

According to a McKinsey (2000) survey of 200 institutional investors from the US, Europe, Latin America and Asia, three-quarters of institutional investors say that Board practices are just as important to them as financial performance when they evaluate companies for investment. They said that they would pay an average premium of 18% for well-governed companies in the UK and US, and a higher premium in other countries. Investors define good governance as having a majority of outside investors on the board who have no ties with management, holding regular director evaluations and are responsive to investor requests for information on governance issues.

The effectiveness of any board of directors is primarily dependent on the integrity and commitment of the people involved, both the directors and the management team. But, it is also important that a responsible and transparent governance system is in place to assure there will be an appropriate focus on relevant, meaningful information and issues.

4.2.B.1. OECD Principles of Board of Directors

4.2.B.1.1. The OECD (1999: pp. 42-45) Principles of the responsibilities of the board

The corporate governance framework should ensure the strategic guidance of the company, the effective monitoring of management by the board, and the board's accountability to the company and the shareholders.

A. Board members should act on a fully informed basis, in good faith, with due diligence and care, and in the best interest of the company and the shareholders.

B. Where board decisions may affect different shareholder groups differently, the board should treat all shareholders fairly.

C. The board should ensure compliance with applicable law and take into account the interests of stakeholders.

D. The board should fulfil certain key functions, including:

1. Reviewing and guiding corporate strategy, major plans of action, risk policy, annual budgets and business plans; setting performance objectives; monitoring implementation and corporate performance; and overseeing major capital expenditures, acquisitions and divestitures.
2. Selecting, compensating, monitoring and, when necessary, replacing key executives and overseeing succession planning.
3. Reviewing key executive and board remuneration, and ensuring a formal and transparent board nomination process.
4. Monitoring and managing potential conflicts of interest of management, board members and shareholders, including misuse of corporate assets and abuse in related party transactions.
5. Ensuring the integrity of the corporation's accounting and financial reporting systems, including the independent audit, and that appropriate systems of control are in place, in particular, systems for monitoring risk, financial control, and compliance with the law.
6. Monitoring the effectiveness of the governance practices under which it operates and making changes as needed.
7. Overseeing the process of disclosure and communications.

E. The board should be able to exercise objective judgement on corporate affairs independent, in particular, from management.

1. Boards should consider assigning a sufficient number of non-executive board members capable of exercising independent judgement to tasks where there is a potential for

conflict of interest. Examples of such key responsibilities are financial reporting, nomination and executive and board remuneration.

2. Board members should devote sufficient time to their responsibilities.

F. In order to fulfil their responsibilities, board members should have access to accurate, relevant and timely information.

Therefore, Boards of directors monitor managers and control companies on behalf of all shareholders. Boards are expected to formulate corporate policy, approve strategic plans, authorize major transactions, declare dividends, and authorize the sale of additional securities. They are also expected to hire, advise, compensate and, if necessary, remove management; arrange for succession; and determine the size of Boards and nominate new members, subject to approval by shareholders.

Although the Saudi Ministerial Resolve No. 70 has shaped the general lines of the responsibilities of Boards of directors and given Boards a wide range of power, it was criticized for not being clear (Al-motairy, 2002).

4.2.B.2. Effectiveness of Boards of Directors

The effectiveness of Boards of directors in monitoring managers, exercising control on behalf of shareholders and improving the protection of shareholders, especially minority shareholders, depends on a number of common factors:

- the representation of independent or non-executive directors on Boards;
- independent Board committees for remuneration, nomination and auditing; and
- splitting the role of the chief executive officer (CEO) from that of chairman of the Board.

4.2.B.2.1. The Representation of Independent or Non-Executive Directors on Boards

Boards are typically composed of inside directors (executive) and outside directors (non-executive). Outside directors are often viewed as representing outside shareholders while inside directors are assumed to represent the management. Inside directors are employees of the firm. They generally are not thought to be independent of the CEO, since the success of their careers is often tied to the CEO's success. Outside directors are not employees of the firm and usually do not have any business ties to the firm aside from their directorship. Outside directors are typically CEOs from other firms or prominent individuals in other fields. Finally, about 10 per cent of directors do not fall into either category; often these are attorneys or business people that have a long-standing relationship with the firm. These directors are usually referred to as "affiliated" or "grey" directors. Studies in the literature focus solely on inside and outside directors (e.g., Collier and Gregory, 1999; Menon and Williams, 1994) and studies that consider "grey" area directors who are not insiders but still have ties to management or the corporation (e.g., Carcello and Neal, 2000; Vafeas, 2001).

The main function of non-executive directors is to ensure that the executive directors are pursuing policies consistent with shareholders' interests, (Fama 1980). Non-executive directors possess two characteristics that enable them to fulfil their monitoring function. First, their independence (Cadbury 1992) and second, they are concerned to maintain their reputations in the external market (Fama and Jensen 1983). There are influences and powerful sources who recommend the need for independent, non-executive directors such as the Council of Institutional Investors in the US, the Cadbury Commission (1992) in the UK, Australian Institutional Investors and all those who would like to become non-executive directors.

According to the Teachers Insurance and Annuity Association College Retirement Equities Fund (TIAA-CREF), independent directors (i) are not present or former employees of the company, and (ii) do not have significant financial or personal ties to the company or its management that could compromise the director's objectivity and loyalty to shareholders. All monetary arrangements with directors for services outside normal Board activities should be approved by an independent Board committee and disclosed in the company's proxy statement.

According to the The California Public Employees' Retirement System (CalPERS), independent directors:

- are not consultants or service providers to the company;

- have not been employed by the company in an executive capacity within the past five years;
- are not, and are not affiliated with a company that is, an adviser or consultant to the company or senior management;
- are not affiliated with a significant customer or supplier;
- have no personal service contract with the company or a senior executive of the company;
- are not affiliated with a not-for-profit organization that receives significant contributions from the company;
- are not, and within the last five years have not been, in a business relationship with the company that requires disclosure pursuant to Regulation S-K;
- are not employed by a company upon whose board an executive officer of company serves;
- have no such relationships with affiliates of their company; and
- have no member of immediate family with such a relationship.

The Hampel Report (1998: para. 3.9) concurred with the recommendations of the Cadbury Code in that it required that, "... a majority of non-executive directors be independent." It was also stated in the Hampel Report (para. 3.14) that,

> ... we believe that it is difficult for them (the non-exective directors) to be effective if they make up less than one third of the board. Thus, board size to some extent must be considered to influence board effectiveness

The Cadbury Report (1992) stipulated a minimum of three non-exective directors. The Hampel Report (1998) went further as it stated that boards with less than three non-exective directors could not be considered effective. The Cadbury Code (1992: paragraph 4.10) also stated that,

> The Committee believes that the caliber of the non-executive members of the board is of special importance in setting and maintaining standards of corporate governance (paragraph 4.10) ... We recommend that the caliber and number of non-executive directors on a board should be such that their views will carry significant weight in the board's decisions. To meet our recommendations on the composition of sub-committees of the board, all boards will require a minimum of three non-executive directors, one of whom may be the chairman of the

company provided he or she is not also its executive head. Additionally, two of the three should be independent (paragraph 4.11).

Therefore, non-executive directors are considered to be in a better position to play a monitoring and controlling function as opposed to executive management due to their independent nature. Research on the ability of non-executive directors to determine compensation (Core et al. 1997) may suggest otherwise. Vance (1983) argued that non-executive directors are more likely to be obligated to the chief executive officer (CEO) for their position and are, therefore, less likely to aggressively challenge and oversee executive management.

4.2.B.2.2. Independent Board Committees for Remuneration, Nomination and Auditing

It has been noted that the Board of directors is an important leg amongst three other legs of one chair – corporate governance. The Board of directors delegates some of its oversight to the audit committee and other committees of the Board. Other corporate governance arrangements added to the Board enable the Board to function more effectively. Common among these arrangements are the sub-committees of the Board (Forker, 1992; Malone, Fries and Jones, 1993; McMullen, and Raghunandan 1996). The Board will work through these committees, composed of members who are appointed by the directors from among their number, in exercising governance over certain activities.

The Cadbury Committee (1992) recommended that all listed British companies should establish internal Board sub-committees to oversee amongst other things the audit process. Board sub-committee structure and quality provide insights into those responsible for undertaking the monitoring roles within companies (Vafeas 1999).

4.2.B.2.2.1. Audit Committee

This Committee would assist the Board in fulfilling its responsibilities in respect of the financial statements. It would also report to the Board on the accounting policies, the contents of annual reports and accounts, the conclusions drawn from internal control reports and the adequacy and scope of the audit. The Committee would not limit its activities to year-end accounts but would have a continuing role during the year with the auditors, both external and internal, attending key meetings and having direct access to the committee charter. The existence of the Committee would help to ensure that the accounting function is kept under review and that the highest importance is attached to the preparation of the financial statements. The independence of the Committee can be enhanced when it is comprised of non-executive members that have financial expertise.

The Treadway Commission Report (1987) concluded that audit committees had a critical role to play in ensuring the integrity of US company financial reports.

The Cadbury Committee Report on the Financial Aspects of Corporate Governance (1992) also recommended that all listed UK companies should establish audit committees. The Cadbury Committee has emphasized the independence of the board committees. It was stated in the Cadbury Report (Cadbury Report, 1992: paragraph 4.35.b) that,

> There should be a minimum of three members (of audit committee). Membership should be confined to the non-executive directors of the company and a majority of the non-executives serving on the committee should be independent.

4.2.B.2.2.2. Nominations Committee

This Committee would meet as necessary and would be responsible for nominating, for the approval of the Board, candidates for appointment to the Board. The role of this Committee might appear less effective in a privately owned company, but a provision for independent non-executive directors would require selection and recruitment criteria to be formally established and applied. The Committee provides important assessment of Board effectiveness and directs the process of renewing and replacing Board members.

The Cadbury Committee Report on the Financial Aspects of Corporate Governance (1992) recommended that,

> One approach to making board appointments, which makes clear how these appointments are made and assists boards in making them, is through the setting up of a nomination committee, with the responsibility of proposing to the board, in the first instance, any new

appointments, whether of executive or of non-executive directors. A nomination committee should have a majority of non-executive directors on it and be chaired either by the chairman or a non-executive director (Cadbury Report, 1992: paragraph 4.30).

Various commentators have raised the question whether independent directors can be truly regarded as independent if the nominating committee and the nomination process are not wholly independent of management. Strine (2002), the Vice Chancellor of the Delaware Chancery Court, in an article discussing the impact of Enron observed that,

Courts are aware that corporate boards are not elected in a process that would be considered fair if replicated by the political processes of our nation. In reality, boards are most powerfully shaped by nominating committees, rather than by stockholders. The proxy mechanism is tilted heavily in favour of the management slate, and contested elections rarely occur outside the takeover context. That puts the independence concept under stress from the start, because outside directors are usually identified and selected in the first instance by the incumbent board members. Traditionally, chief executive officers (CEOs) have played an important role in board selection, a practice that has often resulted in the selection of directors with pre-existing relationships with management (Strine, 2002: pp. 1377) To the extent directors in such companies are nominated in a manner heavily influenced by management – rather than by a nominating committee of independent directors – the presumption that directors' compensation is not a bias-producing factor can be viewed as less sustainable (Strine, 2002: pp. 1384).

4.2.B.2.2.3. Remuneration Committee

This Committee, which would meet typically just twice a year, would be responsible for recommending to the Board the terms and conditions of employment of directors, including executive directors. It might have further responsibility for considering management recommendations and advising the board on appropriate policy for the remuneration and terms of employment of key staff. To minimize the risk of any potential conflict of interest the committee should be composed of a majority of independent non-executive directors.

The Cadbury Committee Report on the Financial Aspects of Corporate Governance (1992) recommended that,

> We also recommend that boards should appoint remuneration committees, consisting wholly or mainly of non-executive directors and chaired by a non-executive director, to recommend to the board the remuneration of the executive directors in all its forms, drawing on outside advice as necessary. Executive directors should play no part in decisions on their own remuneration. Membership of the remuneration committee should appear in the Directors' Report (Paragraph 4.42).

The compensation of executive directors is an important factor in Board effectiveness. The separation of ownership from control means that the compensation of executives plays a central role in governance. The key problem here is one of aligning the interests of managers and shareholders. The exact form of the optimal incentive package depends on the specific details of the agency problem but often involves performance-related pay and the award of stock options to managers.

By tying a manager's compensation to measures of corporate performance, the manager is forced to internalise investors' objectives. This can be reached through performance-related bonuses, stock grants, etc. However, executive incentive pay has been criticized as being manipulated or controlled by the executives themselves. The Remuneration Committee, composed of non-executive directors, has the responsibility to determine, on behalf of the Board and the shareholders, the company's policy on remuneration and the remuneration packages of each of the executive directors.

The Cadbury Code (1992: paragraph 3.3) stated that, "...executive directors pay should be subject to the recommendations of a remuneration committee made up of wholly or mainly of non-executive directors". The reasoning behind this recommendation being that if executive directors rewards are to be linked to performance, those directors benefiting, should not decide on their own remuneration, due to a conflict of interest.

On the other hand, in the literature, it is not clear whether the compensation of non-executive directors enhances corporate governance and firm performance or not. Vafeas (2000) found no significant link between the adoption of outside director incentive plans and operating performance improvements. Cordeiro et al. (2000), taking data on 200 large US corporations in 1996, found a significant relationship between compensation of outside directors and firm performance. They observed that projected earnings per share growth rate is significantly negatively related to cash compensation, but positively related to stock compensation, suggesting a bias towards stock compensation in high growth areas. Perry (2000), studying over 1,600 US firms between 1992 and 1995, documented a significant increase in firms providing outside directors with a financial stake in the performance of the firm through incentive-based compensation. He found that incentive compensation for directors influences the level of monitoring by the Board.

Finally, it is important to mention that the OECD Principles (1999) called on companies to disclose the remuneration of members of the board and key executives so that investors may ensue that corporate pay policies are aligned with the interests of shareholders.

4.2.B.3. Splitting the Role of the Chief Executive Officer (CEO) from that of Chairman of the Board.

The case for splitting the CEO and chairman positions was made by Lorsch and MacIver (1989) who argued that, when the positions were combined, the CEO exercised great power primarily because of his or her expertise in and knowledge of company matters. Also, the CEO controls the agenda and plays an important role in the selection of outside directors. All of these factors impede outside directors fully exercising their power. Lorsch and MacIver (1989) argued that providing a leader separate from the CEO could help directors prevent a crisis and act quickly when one does arise; would give directors a strong voice in setting meeting agendas and in selecting directors; encourage more open discussions in meetings; and would underscore the board's right and obligation to govern the corporation (Lorsch and MacIver, 1989).

Only a small number of corporations in the United States has installed an outside director as a chairman, but the practice has long been common in Great Britain. According to Proned, a London research organization, 80 percent of U.S. public companies combine the jobs, a practice referred to as CEO duality. In Britain the reverse situation is the norm, as only 24 percent of public companies have a combined chairman and chief executive (Stevenson 1992). The Russell Reynolds Associate Survey Board Practices (1998) highlighted that 85 per cent of the Standard and Poors (S&P) 500 companies in the USA do not have separate individuals as chief executive officer and chairman.

Millstein et al. (1998) found that even where the roles of the CEO and Chairman were separated, the chairman in many instances was not independent. Furthermore, Daily et al. (1997) considered the independence of the chairman under both the dual and separate role structures. No statistically significant relationship was found to show that the independence of the chairman was any less when the role was joint as compared to when the role was split. Kenser et al. (1986) noted that shareholder returns were inferior when the CEO and chairman roles were combined.

The combined Code on Corporate Governance (1998) in the UK, however, considers that the separation of the roles to be important to Board effectiveness.

Given that these recommendations have emphasised the importance of splitting the roles of the CEOs and chairmen and given the abovementioned mixture in the literature, the separation of the role of the CEO and chairman was considered to be an important determinant of board effectiveness.

4.2.C. Audit Committees and Internal Audit

The role played by independent non-executive directors on the Board continues to be a prominent feature of corporate governance. One of the most important committees of Boards of directors is the audit committee. The Audit committees of public traded companies have become a common component of the corporate governance structure. The Board of directors selects the members and chair of the audit committee, all of whom need to be able to function as a team. The audit committee should consist of three to five members, depending upon the size and business of the company (the Cadbury Committee, 1992; Blue Ribbon, 1999).

All codes of corporate governance recommend the establishment of audit committees but few jurisdictions have so far actually made them mandatory. Canada and Singapore are exceptions in this respect (Spira, 1999). By law Canadian public companies are generally required to have an audit committee of at least three members, the majority of whom must be independent (PWHC, 1999). Similarly, the

Singapore Companies Act sets out basic requirements in relation to the composition, duties and responsibilities of audit committees (PWHC, 1999).

4.2.C.1. Activities of Effective Audit Committees

The role of audit committees has evolved over the years. The Cadbury Committee Report on the Financial Aspects of Corporate Governance (1992), the Blue Ribbon Committee's (BRC) Report on Improving the Effectiveness of Corporate Audit Committees (1999), the National Association of Corporate Directors' (NACD) Report of the Blue Ribbon Commission on Audit Committees (2000), the National Commission on Fraudulent Financial Reporting (Treadway Commission, 1987) and the Royal Commission on the Economic Union and Development Prospects for Canada (the Macdonald Commission, 1982) all provide numerous recommendations for improving audit-committee effectiveness and highlight the recent surge in interest in performance quality. In addition, some authors and organizations have issued publications on "best practices" for audit committees (e.g., Arthur Andersen, 2000; Burke and Guy, 2001; PwC, 2000; Verschoor, 2000).

The Securities and Exchange Commission (SEC) in the USA and the National Commission on Fraudulent Financial Reporting (1987) in the USA stated that the audit committee is an important element in corporate governance. An effective audit committee is viewed as a critical link in providing investors with reliable financial reporting. The US Securities and Exchange Commission (SEC) has stated that an effective audit committee affords the "greatest possible protection to investors" (Price Waterhouse, 1993). In addition, Wild (1996) documents a significant increase in an entity's earnings response coefficient subsequent to the formation of an audit committee.

4.2.C.1.1. Audit Committees' Functions

Functions normally performed by audit committees vary in accordance with the mission statement or charter granted to them by the board of directors (Rezaee and Farmer, 1994). The Smith Report (Smith, 2003: pp.6) clarified the main roles and responsibilities of audit committees, which should be:

- to monitor the integrity of the financial statements of the company;
- to review the company's internal financial control system and, unless addressed by a separate risk committee or by the board itself, risk management systems;
- to monitor and review the effectiveness of the company's internal audit function;
- to make recommendations to the board in relation to the appointment of the external auditor and to approve the remuneration and terms of engagement of the external auditor following appointment by the shareholders in general meeting;
- to monitor and review the external auditor's independence, objectivity and effectiveness; and
- to develop and implement policy on the engagement of the external auditor to supply non-audit services.

The National Association of Corporate Directors (NACD) mentioned that with each new wave of financial irregularities, the cry for more effective audit committees as an important part of the financial control system becomes even more urgent. Venables et al. (1988) stated that audit committees in the USA and Canada were developed to: (i) increase confidence in the credibility and objectivity of the financial statements; (ii) assist directors in discharging their financial reporting responsibilities; and (iii) to strengthen the independence of the external auditors. Kalbers and Fogarty (1993), investigating the relationship between audit committee power and audit committee effectiveness, found that effectiveness included oversight of financial reporting, external auditors and internal control.

Such concern has lead to recent regulation of the audit committee function in a number of areas, including independence, composition, expertise, disclosure of activities, discussion of financial reporting quality, and materiality assessment (e.g., BRC, 1999; Sarbanes-Oxley, 2002; SEC, 1999a; and SEC, 1999b).

Wolnizer (1995) summarised the functional audit committee recommendations of corporate governance commissions and committees in the US, UK, Canada and

Australia. He demonstrated that the audit committee is expected to perform almost exclusively in the technical areas of financial reporting, auditing and internal control.

Therefore, the audit committees' common functions in the literature and most accepted international corporate governance recommendations and publications (e.g., Smith, 2003; Wolnizer, 1995; Arthur Andersen, 1998; BRC, 1999; Burke and Guy, 2001; Grant Thon, 1997; KPMG, 1999; PwC, 1999; Rittenberg and Nair, 1993; and others) include:

- internal control assessment (e.g., reviewing the adequacy of the system of internal control; reviewing the scope of internal auditing activities);
- financial reporting process; and
- external auditing (e.g., appointing or removing external auditor; reviewing the external auditing plans; approving the provision of consultancy services by the external auditors; reviewing the independence of the external auditors).

4.2.C.1.1.1. Internal Control Assessment

The internal audit function is important in achieving an effective audit committee. Raghunandan et al. (2001) linked audit committee member independence and expertise to influence with internal auditors via private access to chief internal auditors, amount of meeting time with chief internal auditors, and ability to review internal audit activities and results. The KPMG's Audit Committee Institute (2001) evaluated audit committee members' perceptions about effective use of the internal audit function. DeZoort (1997) surveyed audit committee members' perceptions of their responsibilities in areas related to financial reporting, auditing and overall corporate governance. Members consistently ranked internal control evaluation as the most important oversight area, with financial statement review and internal auditor/external auditor evaluation considered highly important.

The KPMG's Audit Committee Institute (1999, 2000, 2001) found that audit committee members tended to agree that internal auditors are "well equipped" to identify material weaknesses in internal controls. Beasley et al. (2000) also found that companies in technology, health care and financial services industries had less internal audit support than no-fraud industry benchmarks. Raghunandan and McHugh

(1994) found that audit committee involvement in the hiring and firing of the internal audit head was associated with the number of meetings with him. Finally, the results in DeZoort et al. (2000) emphasised that internal audit members have agreed that communications between internal auditors and audit committees could improve the quality of corporate governance. Bishop et al. (2000) reported on the forces in the US reshaping and reforming audit committees. They argued that extending and expanding interaction between audit committees and internal auditors can enhance the quality of corporate governance and strengthen the organisational infrastructure.

According to Wolnizer (1995: pp. 48), the audit committee's responsibilities in the internal audit functions include:

- evaluate the independence and competence of the internal audit function;
- discuss with the chief of internal auditors:
    - internal audit findings and reports;
    - effectiveness of internal controls; and
    - problems in performing the internal audit.
- review the scope of internal audits planned for the year;
- review management's response to internal auditors' recommendations;
- review and approve internal audit budget;
- review the relationship between internal and external auditors and co-ordination of their work; and
- appoint and dismiss the head of internal audit.

It is important to mention here that a key characteristic of an effective internal audit department is the independence with which it operates. Independence is crucial to the nature of internal audit as it allows the internal auditor to render impartial and unbiased judgement. It is best achieved through organisational objectivity.

The essence of the relationship between the internal auditors and the audit committee is to provide reporting independence (i.e., the internal auditors have the ability to report all deficiencies to an authority without fear of reprisal by management). The chief internal auditor should have direct communication with the audit committee.

The audit committee could also protect the independence of the internal audit department by ensuring that the chief internal auditor is not dismissed as a result of reports which reflect unfavourably on management. The Treadway Commission stressed that the audit committee should review the appointment and dismissal of the chief internal auditor.

Scarborough et al. (1998), examining the relationship between the audit committee and internal audit, found that audit committee composition did influence the extent of interaction between the audit committee and internal audit. Raghunadan et al. (2001) also examined the association between audit committee composition and the committee's interaction with internal auditing and found that audit committee composition influenced the extent of committee interaction with internal auditing.

4.2.C.1.1.2. Financial Reporting Process

The audit committee is responsible for reviewing the financial statements and considering whether they are complete and consistent with the information known to management. The financial reporting process and ensuring reliable financial information is one of the most important functions of audit committees (Rezaee and Farmer, 1994).

> While the audit committee should not become involved in day-to-day operations, there is pressure from the oversight role for the audit committee to get more involved to ensure the integrity of the financial reporting process (Rezaee and Farmer, 1994: 14).

The Blue Ribbon Report (1999) stated that audit committees do not prepare financial statements, but rather are responsible for monitoring and overseeing the financial reporting process. To fulfil its responsibilities, the audit committee must ensure that proper internal controls are established, must be familiar with the company's risk assessment policies and must be informed of critical accounting choices for any kind of transaction or judgement decisions. McMullen and Raghunandan (1996) found that companies with financial reporting problems were less likely to have CPAs on the audit committee. The audit committee also should meet regularly and as needed with the company's CFO, comptroller, internal auditor, and other personnel responsible for the company's financial reporting process and internal controls, as well as with the outside auditor.

According to Rezaee and Farmer (1994), Wolnizer (1995), Lee and Stone (1997) and Smith (2003), the audit committees' roles in the financial reporting processes include:

- review all financial statements, whether interim or annual, before they are approved by the board of directors and publicly disseminated to ensure their objectivity, accuracy and timeliness;
- review all existing accounting policies, and concentrate on the impact on the financial statements of any changes in accounting policies including the likely impact of any contemplated changes;
- evaluate exposure to fraud;
- appraise key management estimates, judgements, and valuations where they are thought to be material to the financial statements;
- evaluate the adequacy of financial statement disclosures;
- review adequacy of organization's structure, including management's implementation of internal controls; and
- review all significant transactions, especially those that are non-routine and those that might be illegal, questionable or unethical.

Studies in the US literature have found positive associations between the existence of the audit committee and various proxies for the quality of financial reporting. Defond and Jiambalvo (1991) found that companies overstating their earnings were less likely to have an audit committee. McMullen (1996) found a positive relationship between audit committee existence and the quality of financial reporting. Wild (1996) found a positive relationship between audit committee formation and the quality of accounting earnings.

The Treadway Commission Report (1987) recommended that the audit committee oversee the internal reporting process. This recommendation has been adopted in the USA, as SEC rules require that the audit committee review the internal reports. However, according to the Macdonald Commission (1988) and Cadbury Commission (1992), it is not mandatory for the audit committee to undertake the financial reporting review in Canada and the UK, respectively. The Macdonald Commission only recommended that the audit committee review financial information before publication, and the Cadbury Report only recommended that the audit committee review the half-year reports before submission to the board for approval.

4.2.C.1.1.3. External Audit

The audit committee is directly responsible for the nomination, compensation, and oversight of the outside auditor. A number of studies (e.g., Cohen and Hanno, 2000; Knapp, 1987, 1991; Schroeder et al., 1986) highlight the importance of the external auditor in pursuing effectiveness of audit committees. Cohen et al. (2000) found that external auditors made less favourable audit planning judgments in cases where the corporate governance structure included an audit committee that lacked technical experience and regular access to internal and external auditors without top management present.

Accountability to shareholders and other stakeholders is achieved primarily through financial reports (Pincus et al., 1988) that have been subject to a statutory external audit. Whilst the problems regarding user perception may be to some extent addressed by better disclosure and an expansion in the nature and scope of external audit assignments to reflect these concerns, the problems associated with the credibility of external auditors and the perceived lack of independence still remains.

Knapp (1987) found that the use of a Big 8 audit firm was associated with increased audit committee support for the auditor in auditor management disagreements. This finding supports the argument in the literature that audit quality and auditor credibility are associated with audit firm size. Knapp (1991) found that audit committee members perceived Big 8 firms were more likely to discover material errors than local firms. In addition, members believed that length of auditor tenure was positively related to audit quality in early engagement years, but negatively related to audit quality in later years.

According to Wolnizer (1995: pp. 47), the audit committees responsibilities toward external auditors include:

- review the findings of the external audit;

- determine the completeness and appropriateness of management's response to audit findings;
- evaluate independence of the external audit function;
- review the reasonableness of the external audit fees;
- arbitrate in disputes between management and auditors;
- nominate external auditors;
- review the management letter prepared by the independent auditors; and
- discuss with external auditor:
    - conduct and problems of the audit;
    - audited financial statements; and
    - scope and timing of the audit.

The audit committee should meet regularly with the internal and external auditors with and without senior members of management present. It is important that the audit committee have a way of ascertaining whether the auditors have had disagreements with management and how these disagreements have been resolved. The audit committee should also review with the auditors whether all the systems and procedures are adequate and whether there are any material systems and controls that need strengthening (Cohn et al., 2000; Knapp, 1987).

It is important that the audit committee review the criteria for external auditor independence. The SEC, following the recommendations of the Blue Ribbon Committee on the Effectiveness of Corporate Audit Committees (1999), adopted rule amendments requiring reporting companies to include a report disclosing whether the audit committee has taken certain actions. Specifically, the audit committee report should have to disclose:

- whether the audit committee has reviewed and discussed certain matters with the independent auditors; whether the audit committee has reviewed and discussed the audited financial statements with management; and
- whether the audit committee has discussed with the independent auditors certain matters required under SAS 61 auditing standards and whether they have received and discussed the information required by independent standards Board Standard No. 1 regarding the auditors' independence.

Therefore, the disclosure requirements on external auditor independence in the USA highlight the extent to which the role of the external auditors and their relationship with the audit committee is considered to be a key mechanism in corporate governance.

4.2.C.2. Developments in Audit Committee Effectiveness

As a result of shareholder suits, governmental investigations and criminal proceedings arising from recent financial debacles at Enron, WorldCom, Adelphia and others, liability is lurking around every corner of the corporate world for directors, officers, outside auditors and members of audit committees (Buchalter et al., 2003). Expectations of audit committees have increased dramatically (e.g., BRC, 1999; Burke and Guy, 2001; Grant Thornton, 1997; Levitt, 1998; Rezaee and Farmer, 1994; SEC, 1999b) with a number of other initiatives bringing focus to the challenge of achieving effectiveness.

The audit committee has responsibilities to the entire Board of directors, current shareholders, and regulators (Price Waterhouse, 1993). One function of the audit committee is to help protect the independence of the external auditor (Price Waterhouse, 1993). The Public Oversight Board (POB)[1] (1993) has stated, "...In too many instances the audit committee members do not perform their duties adequately". Similar findings have been reported by other professional and regulatory groups, both domestically and internationally (e.g., Cadbury Committee, 1992; and Sommer, 1991).

In the literature, authors have indicated a great deal of variation in both perceived and stated responsibilities of audit committees (e.g., Abdolmohammadi and Levy, 1992; Coopers & Lybrand, 1995; DeZoort, 1997; and Kalbers, 1992a) and the need better to understand responsibilities to improve the effectiveness of audit committees (e.g., Rittenberg and Nair, 1993). Coopers et al. (1995) argued that the scope of audit committee activity had expanded considerably over the two decades. They found that most of the audit committees conducted a wide range of oversight duties.

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[1] In the Public Interest: A Special Report by the Public Oversight Board of the SEC Practice Section, AICPA. Stamford, CT: Public Oversight Board (1993).

Pincus et al. (1988) noted that audit committees enhance the board's capacity to act as a management control by providing a more detailed knowledge and understanding of the financial statements and other financial information issued by the organization. Lee and Stone (1997) studied 100 U.S. multi-national companies and found a "mismatch" between audit committees' stated responsibilities and the levels of instrumental experience (defined as skills related to accounting, auditing, and control issues) among members.

Rezaee (1997) pointed out that,

> The effectiveness of the audit committees' involvement in corporate governance and the extent of the board of directors reliance on audit committees' services depends on the availability of resources and the degree to which audit committee members are independent from management (pp.34).

Therefore, the author introduced three audit committee attributes that enhance the effectiveness of audit committees and help audit committee members to achieve their expected roles and responsibilities. These attributes are:

- independence;
- expertise; and
- resources (Charter).

4.2.C.2.1. Independence

Audit committees must be independent to achieve their expected roles and functions (Rittenberg and Nair, 1994). Raghunandan et al. (2001) reported survey results indicating that audit committees composed only of independent directors were more likely to have stronger relationships with internal auditors than were audit committees with one or more insiders.

The Treadway Commission (1987) recommended that the board of directors of all public companies should be required to establish audit committees composed solely of independent directors. The Blue Ribbon Committee on Improving the Effectiveness of Corporate Audit Committees (1999) also recommended that companies should have audit committees comprised entirely of independent outside directors.

The Cadbury Committee (1992) stated that, "all listed companies should establish an audit committee" (paragraph 4.35). The Cadbury Committee emphasised the independence of audit committee members. It was stated that,

> There should be a minimum of three members. Membership should be confined to the non-executive directors of the company and a majority of the non-executives serving on the committee should be independent (Cadbury Report, 1992: paragraph 4.35.b).

The NYSE requires listed companies to have at least a two-member audit committee composed of all independent directors (Blue Ribbon Committee, 1999). The NYSE Listed Company Manual (1999) characterizes independent directors as those who are,

> independent of management and free from any relationship that, in the opinion of the Board of Directors, would interfere with the exercise of independent judgement as a committee member. (Treadway Commission 1987: pp. 41; Blue Ribbon Committee 1999: pp. 1079).

The Treadway Commission (1987) mentioned that the New York Stock Exchange (NASD) requires that all national market system companies establish and maintain audit committees that have a majority of independent directors. The Blue Ribbon Committee (1999: p.1079) described an independent director as,

> a person other than an officer or employee of the company or its subsidiaries or any other individual having a relationship that, in the opinion of the board of directors, would interfere with the exercise of independent judgement in carrying out the responsibilities of a director

Willis and Lightie (2000) analyzed the annual reports of the Fortune 100 in 1998 and found that 78 companies had included management reports on their internal controls. Of these, 74 (95%) referred to an audit committee, 92% said its members were independent or not part of management, 81% said the audit committee regularly met with the independent auditor, 78% with the internal audit director and 76% with management. Of the 74 companies with an audit committee, 78% said the committee was responsible for oversight of the financial reporting process, 81% review of internal controls, 69% review of the scope and results of internal and independent audits performed, and 27% oversight of the internal and independent audit functions.

McMullen and Raghunandan (1996) found that companies without reporting problems were more likely to have an audit committee composed solely of outside directors than companies with reporting problems.

> To be effective, such a committee must be made up of independent directors representing public shareholders. If given relatively specific responsibility for the review of both independent auditing and financial reporting, it can, without destroying the present structure of the accounting profession, separate independent auditors from management in a way that should strengthen the independence of the former without usurping any of the operating responsibilities of the latter (Mautz and Neary, 1979: 84).

4.2.C.2.2. Expertise

Audit committee experience/expertise is perceived to be a critical component of the effectiveness of audit committees, yet many authors (e.g., Beasley and Salterio, 2001; DeZoort, 1997; General Accounting Office (GAO), 1991; Kalbers, 1992a, 1992b; and Lee and Stone, 1997) have concerns with audit committee members' expertise levels. Audit committee expertise is associated with factors including: (i) greater interaction with internal auditors; (ii) reduced incidence of financial reporting problems; and (iii) greater support for auditors in auditor-management disagreements.

DeZoort et al. (2001) found that companies with suspicious auditor switches had fewer audit committee members with experience in accounting, auditing or finance than their non-switching counterparts. Beasley and Salterio (2001) studied Canadian boards and found that voluntary increases in audit committee members' collective financial reporting and audit committee knowledge and experience were related to board size, proportion of outsiders on the board and separation of board chair and CEO/president. The General Accounting Office (GAO) (1991) found that approximately half of the 40 surveyed audit committee chairs from large U.S. banks perceived their audit committee had no members with expertise in assigned accounting, auditing, banking and legal oversight domains. DeZoort (1997) found that audit committee members believed that all audit committee members should have sufficient expertise in oversight areas related to accounting, auditing and the law.

Each of these studies identified audit committee member experience and an awareness of technical issues as a prerequisite for committee effectiveness. It is therefore reasonable to consider that an audit committee composed of non-executive directors, who possess sufficient background experience, will be effective.

The *Sarbanes-Oxley Act* (2002) requires US companies to disclose whether, and if not – why not, the audit committee includes at least 1 financial expert, who has (Seaman, 2003: 15):

- an understanding of GAAP;
- experience in the preparation or auditing of financial statements of generally comparable issuers;
- experience in the application of principles in connection with estimates, accruals, and reserves;
- experience with internal accounting controls; and
- an understanding of audit committee functions.

Hurtt et al. (1999) claimed that financial literacy for audit committee members consists of "the ability to read and understand fundamental financial statements, including a company's balance sheet, income statement, and cash flows statement" (pp. 124). The Blue Ribbon Committee (1999) suggested that members of the audit committee with limited familiarity with finance could achieve financial literacy through company-sponsored training programmes. This level of literacy can also be achieved through completion of a basic financial accounting course such as those taught in most MBA programmes at colleges and universities (Hurtt et al, 1999).

4.2.C.2.3. Resources (Charter)

The audit committee charter is an important resource in ensuring an effective audit committee. The charter is "a formal statement of the charge, or to acknowledge the existence of the audit committee in the corporate bylaws" (Pomeranz, 1997: 282). In the United States, most audit committees were working with charters written in the 1970s. The charters were very short and consisted of four to eight lines of text.

The Blue Ribbon Committee (1999: pp. 1073) recommended that each company's audit committee adopt a written charter that:

- describes its responsibilities and how it carries out those responsibilities;
- is approved by the full board;
- is reviewed and assessed on an annual basis;
- specifies that the outside auditor is ultimately accountable to the board and the audit committee;
- requires a dialogue with the auditor about all relationships that may impact the auditor's objectivity and independence; and
- requires the taking of appropriate action by the audit committee to ensure the independence of the outside auditor.

The major purpose for developing a charter is to establish formally the audit committee as a functional element of the company's over-all organisational structure (Rezaee and Farmer, 1994). According to Arthur Andersen[2] (1991), the committee's charter should detail:

- the committee membership and term of office;
- roles and responsibilities;
- relationship with management;
- internal and external auditors; and
- frequency and timing of meetings.

Therefore, the charter defines the background and experience requirements for audit committee members and sets guidelines for the committee's relationships with management, external auditors and others. This document should not be complex, and it should be approved by the board and discussed with management and the auditors (Arthur Andersen, 1991). This charter is developed, periodically up-dated, and approved by the governing board.

Raghunandan et al. (1994) argued that a charter establishes a framework to enhance the effectiveness of the audit committee. Bean (1999) argued that, "a

[2] Arthur Andersen is still working in Saudi Arabia.

comprehensive charter enhances the effectiveness of the audit committee, serving as a road map for committee members" (pp. 47).

Recent SEC pronouncements, that have been effective since June 2001, have required all US listed companies to state whether the audit committee has adopted a written charter.

The audit committee roles and responsibilities are laid down in the charter. Therefore, it is reasonable to infer that audit committee effectiveness must be affected by the existence of a charter.

4.2.D. Disclosure and Transparency

Transparency refers to the principle of creating an environment where information on existing conditions, decisions and actions is made accessible, visible and understandable to all market participants. Disclosure refers to the process and methodology of providing the information and making policy decisions known through timely dissemination and openness.

The financial crises in many countries around the world and their aftermath have underscored the need for a more transparent environment for investment, fair competition and building confidence in the transparency and accountability of both the public and corporate sectors. These crises have highlighted the fact that the long-term health of any financial system and corporate sector depends on practices that adequately protect outside investors. Reliable financial information and disclosures are an efficient means of protecting shareholders and are at the heart of corporate governance and the restoration of investor confidence and market efficiency (Nowroozi, 2000).

Disclosure and transparency have been noted to play an important role in the corporate governance system of firms (Bushman and Smith, 2000). The Blue Ribbon Committee (2000) emphasised that:

> If a corporation is to be a viable attraction for capital, its board must ensure disclosure and transparency concerning the company's true financial performance as well as its governance practices" (p.10).

The OECD (1999) prescribed that

> "the corporate governance framework should ensure that timely and accurate disclosure is made on all material matters regarding the corporation, including the financial situation, performance, ownership, and governance of the company" (pp.21).

Thus, disclosure and transparency are key pillars of an effective corporate governance framework because they provide all the stakeholders with the information necessary to judge whether their interests are being protected. To maintain integrity and to function fairly and efficiently, the market needs high quality information, timely disclosures and efficient access to such information. Investors need this information to make investment decisions and to trade. When relevant information is not properly disclosed in a timely fashion, when insiders abuse their positions and misuse information, or when misleading information is given, this will destroy market fairness and integrity and the level playing field.

Transparency and disclosure are keys to effective corporate governance. Information about a company usually includes: financial results of the company; major share ownership; members of the board of directors and key executives and their remuneration; governance structures; and company objectives and policies. The quality of transparency and disclosure depends partly on accounting and auditing standards and the financial reporting system. The ingredients for transparency and accountability revolve around accurate and complete financial statements. Accounting is indeed the language of business and financial statement disclosure is the means by which the status of a company is communicated to shareholders, potential shareholders and others who have an interest in the firm. Independence of auditing is a key to ensuring that the information disseminated is reliable and credible. Good financial reporting systems facilitate easy access to reliable and credible information by shareholders and other investors. Transparency, therefore, refers to the availability of information to the general public and clarity about government rules, regulations, and decisions.

The formal requirements of disclosure in Saudi Arabia take us back to the initialisation of the Company Regulations issued by Royal Decree No. M/6, dated 1965, requiring companies to prepare financial statements audited by a licensed CPA.

The Ministerial Resolve 89 stated that Boards of directors must prepare a balance sheet, an income statement, a report about the company's activities and its financial status and the intended method of the revenue allocations every financial year and at least 60 days before the general meeting (Ministry of Commerce, 1965). These documents must be accessible to shareholders at least 25 days before the general meeting. Also, the Resolve mentioned that the board must disclose in a public newspaper the abovementioned documents.

Two essential conditions for the existence of a fair market are that information should be available to all players at the same time and that the rules that govern the market are known to everyone (Keong, 2002). Complete information on the processes and their results not only ensure fairness but also improve the market as well as company efficiency and value. It should be ensured that timely and accurate disclosure is made on all relevant matters about the company. The OECD (1999) stated that disclosure should not be conservative and not limited to a few variables. Besides the more obvious operating results of the company, the shareholders should be provided with facts on the remuneration of the board and key executives, material foreseeable risk factors, and material issues regarding employees and other shareholders.

The quality of information disclosure and transparency has been the subject of an increasing stream of academic research. Studies suggest that better disclosure has a positive impact on the efficient functioning of capital markets. Healy and Palepu (2001) reviewed research on financial reporting and voluntary disclosure of information by management and concluded that the increased pace of entrepreneurship and globalization has increased the value of reliable information in capital markets. Verecchia (2001) and Dye (2001) provided comprehensive reviews of the theoretical research on disclosure and related issues over the last two decades.

Gelos et al. (2002) examined whether country transparency affects international portfolio investment or not using new measures of transparency and a unique micro-data set on international portfolio holdings of emerging market funds. They distinguished between government and corporate transparency. There was clear evidence that funds invest systematically less in less transparent countries. Herding among funds tends to be more prevalent in less transparent markets. Funds seemed to react less strongly to macroeconomic news about opaque countries. There was also some evidence that during crises, funds flee non-transparent countries to a greater extent.

In further research on disclosure and transparency, Standard & Poor have introduced the new disclosure and transparency (T&D) rankings to provide an objective, transparent, globally consistent, and replicable measurement of the levels of disclosure provided by the largest and most liquid companies in more than 30 countries.

The value-added of increased transparency is also considered in several recent studies (Brown and Han, 1992; and Gibson, Tamburini and Tuchschmid, 1998). These studies have provided evidence that transparency promotes greater convergence of beliefs and significantly improves the accuracy of analyst earnings forecasts. In these studies, empirical results on the quality of disclosure support the conjecture of Strong and Walker (1987) and Ohlson (1987) that public information causes convergence of beliefs which leads to more complete markets which, in turn, lead to improved risk-sharing.

There are, however, several factors which reduce incentives for transparency (the release of accurate, complete and timely information in the annual report). Among them are the threat of product-market competition (Darrough and Stoughton, 1990; and Chen 1994), tax avoidance considerations, conflicts of interest among various classes of shareholders and finally the management's fear of losing the confidence of a diffused ownership.

A study of Swiss non-financial exchange-listed firms, by Gibson, Tamburini and Tuchschmid (1998), showed that the analyst rating (a measure of the quality of the disclosure in the annual report) increased with the equity free float (a measure of the degree of openness of the firm) and with the number of financial analysts that follow the firm, suggesting an additional incentive to disclose.

4.2.D.1. The OECD Principles of Corporate Governance on Disclosure and Transparency

The OECD principles (1999) prescribe that,

> the corporate governance framework should ensure that timely and accurate disclosure is made on all material matters regarding the corporation, including the financial situation, performance, ownership, and governance of the company" (pp.21).

There are, however, specific issues that need to be addressed in regard to the requirements of disclosure and transparency. The following are excerpts from the *OECD Principles of Corporate Governance* (1999: Section IV. Disclosure and Transparency). They are quoted here because of the clarity and simplicity of the language used in explaining the various issues involved.

A. Disclosure should include, but not be limited to, material information on:

1. The financial and operating results of the company.
2. Company objectives.
3. Major share ownership and voting rights.
4. Members of the board and key executives, and their remuneration.
5. Material foreseeable risk factors.
6. Material issues regarding employees and other stakeholders.
7. Governance structures and policies.

B. Information should be prepared, audited, and disclosed in accordance with high quality standards of accounting, financial and non-financial disclosure, and audit.

C. An annual audit should be conducted by an independent auditor in order to provide an external and objective assurance on the way in which financial statements have been prepared and presented.

D. Channels for disseminating information should provide for fair, timely and cost-efficient access to relevant information by users. (OECD, 1999: Section IV)

Therefore, it can be seen from part 'A.1' above that the most widely used source of information on companies is the audited financial statements that show the financial performance and the financial situation of companies (e.g., balance sheet; profit and loss statement; cash flow statement and notes to the financial statements).

Management's discussion and analysis of operations should also be included in annual reports. Investors are particularly interested in information that may shed light on the future performance of the enterprise.

The Principle 'A.2' emphasises that companies should disclose their commercial objectives and policies relating to business ethics, the environment and other public policy commitments. Also the Principle 'A.3,' shows that one of the basic rights of investors is to be informed about the ownership structure of the enterprise. Such disclosure might include data on major shareholders and others that control the company, including information on special voting rights, shareholder agreements, the ownership of controlling or large blocks of shares, significant cross shareholding relationships and cross guarantees.

Principle 'A.4' shows that investors require information on individual board members and key executives in order to evaluate their experience and qualifications and assess any potential conflicts of interest that might affect their judgement. They also need information on reasonably foreseeable material risks (see Principle A.5) that may include: risks that are specific to the industry or geographical areas; dependence on commodities; financial market risk including interest rate or currency risk; risk related to derivatives and off-balance sheet transactions; and risks related to environmental liabilities. Companies are also encouraged to provide information on key issues relevant to employees and other stakeholders that may materially affect the performance of the company and to report on how they apply relevant corporate governance principles in practice (see Principles A.6 and 7 above).

From the Principle 'B' it could be realized that high quality standards are expected to improve significantly the ability of investors to monitor the company by providing increased reliability and comparability of reporting, and improved insight into company performance.

The independence of auditors (Principle C) and their accountability to shareholders is an issue that has been given attention by many companies, authors and corporate governance organizations all over the world. The OECD (1999) by stating the Principle 'C' above has considered the importance of auditor independence, too. The OECD countries have paid attention to this issue, too, and some of them apply limitations on the percentage of non-audit income that the auditor can receive from a particular client. Other countries require companies to disclose the level of fees paid to auditors for non-audit services. It is widely felt that the application of high quality audit standards and codes of ethics is one of the best methods for increasing independence and strengthening the standing of the profession.

Following the OECD Principle 'D,' some countries have started to enhance filing of statutory reports by electronic filing and data retrieval systems. In Saudi Arabia, a major development in the stock market was the introduction of an electronic stock trading system (Tadawul) on October 6, 2001. Market prices, news, regulatory announcements, corporate information and companies' financial statements become available to everyone, as it happens, within the Kingdom and abroad, which has boosted the disclosure and transparency of the Saudi market.

4.2.D.2. Disclosure, Transparency and Financial Statements

The objective of financial statements is to provide information about the financial position (balance sheet), performance (income statement) and changes in financial position (cash flow statement) of a firm (Greuning, 1999).

The transparency of financial statements is secured through full disclosure and by providing fair presentation of useful information necessary for making economic decisions to a wide range of users. Financial statements should be easy to interpret but the provision of information to the market is costly. Therefore the net benefits of additional transparency should be carefully assessed.

The adoption of internationally accepted accounting standards is a necessary measure to facilitate transparency and proper interpretation of financial statements. The framework for financial accountability depends on the prevailing cultural norms in each country and it may consist of a complex set of relationships, rules and regulations.

International standards of accounting define the basis for the financial reporting and disclosure for accountability and transparency. The International Accounting Standards Board in 1989 (amended in 2001) developed a *Framework for* *the Preparation and Presentation of Financial Statements,* which describes the basic concepts by which financial statements are prepared. The Framework serves as a guide to the Board in developing accounting standards and as a guide to resolving accounting issues that are not addressed directly in an International Accounting Standard or International Financial Reporting Standard. This framework:

- defines the objective of financial statements;
- identifies the qualitative characteristics that make information in financial statements useful; and
- defines the basic elements of financial statements and the concepts for recognising and measuring them in financial statements.

However, in the absence of comprehensive useful information, even managers may not be aware of the true financial condition of their enterprise, and other key market participants may be misled. This may prevent the market to act as an intermediary of the price discovery mechanism and discourage investors from taking the risk to invest in the particular enterprise (Yener, 2002).

According to the International Accounting Standards Board, there are four-key qualitative characteristics of accounting that make financial statements useful to users:

- relevance: nature and materiality of information;
- reliability: true and faithful representation of financial status; substance; neutrality; prudence and completeness;
- comparability: with financial statements of other firms; and
- understandability: informational content

But these characteristics are subject to the following constraints:

- timeliness: the financial information must be provided on a timely basis, but at times a delay may improve reliability, at the cost of relevance;
- benefit vs. cost: the benefit of having this information must outweigh the cost of providing it.

- balancing of qualitative characteristics: the company providing this information must achieve an appropriate balance among the abovementioned qualitative characteristics;
- fairness: the information should be a fair representation of the economic reality of events and transactions in a given year, and users can find all relevant aspects of the firm's financial performance and position.

4.2.D.3. Transparency and Disclosure Measurements

Standard & Poor have published a study that examines the transparency and disclosure practices of major public companies around the globe. The study was launched in 2001 in Latin America and Asia, and in 2002 the study was extended to the S&P/TOPIX 150 in Japan. The transparency and disclosure methodology incorporates disclosure items from the criteria that Standard & Poor's Governance Services uses in its interactive corporate governance scoring service. Standard & Poor's has introduced a methodology to assess the level of transparency and disclosure, which is evaluated by searching company annual reports for the information of 98 possible attributes broadly divided into the following three sub-categories:

- ownership structure and investor relations (28 attributes);
- financial transparency and information disclosure (35 attributes); and
- board and management structure and process (35 attributes).

The Standard & Poor's Transparency & Disclosure scores was a proprietary evaluation of corporate disclosure patterns and have covered approximately 1,600 companies, covering the Standard & Poor's Global 1200 index and an additional 400 companies representing the leading companies in Standard & Poor's/IFCI emerging markets index. The S&P Global 1200 represents leading global companies and includes the S&P 500, 150 companies in Japan, and 350 companies in Europe. These 1,600 companies cover over 40 markets and represent approximately 70% of the world's tradable market capitalization.

The Transparency & Disclosure scores are developed from the analysis of the latest available annual reports, and assess the level of transparency and disclosure of companies in emerging markets (Asia, Latin America, central and eastern Europe, and Africa) as well as developed markets (Europe, developed Asia and US).

4.3. MEAURING THE MECHANISMS OF EFFECTIVE CORPORATE GOVERNANCE

The academic literature has emphasized the importance of effectiveness, which could be seen by the frequency of reference to the concept in the titles of papers (e.g., Ecton and Reinstein, 1982; Spangler and Braiotta, 1990; Verschoor, 1990a,b; Kalbers and Fogarty, 1993; Cameron, 1986; and others). However, these studies reveal that the characteristics contributing to effectiveness are not always easily identifiable and research into their impact is equivocal in its conclusions.

Measures of effectiveness are difficult to establish and criteria tend to be confined to those factors which can be quantified (Spira, 1999). Spira (1999: 32) also noticed that, "there is no discussion of the meaning of effectiveness, resources, or independence within the literature and this assertion is unsupported". Lee and Stone (1997: 98) in explaining the purpose of their study noted that, "actual effectiveness was impossible to observe".

In addition, Cameron (1981) stated that organisational effectiveness has become "an enigma," and the meaning of effectiveness in academic research is unclear because of the variety of referents used. Therefore, evaluators of organisational effectiveness will never measure all of the relevant aspects of effectiveness of an organisation from all the relevant points of view. For this reason, it is very important that evaluators make clear certain critical choices they make when measuring effectiveness.

However, Cameron (1981) added that effectiveness is an "elusive" concept that can be approached through several models, none of which is appropriate in all circumstances. Cameron (1986: 544) argued that,

> there is no single model or criteria for organisational effectiveness. There cannot be a single theory about effectiveness, and the primary task facing any investigator of effectiveness lies in determining what are the appropriate indicators and standards.

For this reason, the selection of data by which to measure effectiveness is important because an organisation may be judged effective on the basis of biased data (Cameron, 1981: 10). Cameron (1981) also compared twenty-one empirical studies of organisational effectiveness on the basis of the type of effectiveness criteria used and the sources from which the criteria were derived, and it was discovered that no overlap occurred in the criteria of effectiveness in approximately 80 per cent of the studies.

Baugher (1981) argued that there is often no single model for defining effectiveness in any given situation. It was noted that it is possible to say that the investigator should focus on a particular type of effectiveness. However, one could look at effectiveness from one perspective and ineffectiveness from another perspective. It was concluded that "the investigator should determine which type of effectiveness is of the greatest concern to the constituency or constituencies to which he or she must report" (pp. 102).

Therefore, in this thesis, the word "effectiveness" refers to corporate governance mechanisms as follows: shareholders get their rights; boards of directors and audit committees carry out their specific oversight responsibilities; disclosure and transparency are timely and sufficient.

4.4. SUMMARY

Although observers in the literature have increasingly come to recognize that governance mechanisms (e.g., shareholders' rights, board of directors, audit committees and disclosure and transparency) should work together in a system, much of the previous research has focused only on individual mechanisms. This has contributed a great deal to knowledge about these particular instruments but left gaps in our understanding of how these mechanisms jointly could enhance the effectiveness of corporate governance system as a whole.

The corporate governance mechanisms, just described, should not be viewed in isolation from each other. Again, it has been generally argued that these elements jointly enhance the effectiveness of corporate governance in a firm.

CHAPTER FIVE:

CORPORATE GOVERNANCE EFFECTIVENESS IN SAUDI ARABIA:

THEORY, LITERATURE AND HYPOTHESES

5.1. INTRODUCTION

The international organizations discussed in the previous chapters such as the International Monetary Fund (IMF), the Organization of Economic Cooperation and Development (OECD), the World Bank and others are very keen on governance issues. The IMF has demanded that governance improvements be included in its programs. In 1999 (amended in 2004), the OECD issued its influential *OECD Principles of Corporate Governance*, which are intended to assist member and non-member countries in their efforts to evaluate and improve the legal, institutional and regulatory framework for better corporate governance. The World Bank has always encouraged developing countries to adopt international best practices and implement legal and regulatory reforms. In addition, private sector organizations, such as Standard & Poor, California Public Employees' Retirement Pension System (CalPERS), Credit Lyonnaise Securities Asia[1] (CLSA) and McKinsey, are also calling for sweeping reforms of governance practice in emerging economies.

Corporate governance has gained importance in Saudi Arabia, too. The Saudi government initiated stock trading in 1935 in order to raise capital and improve operating performance. By the year 1947, Saudi's stock market has grown

[1] CLSA is a leading provider of brokerage, investment banking and direct investment services in the Asia-Pacific markets. Founded in 1986 and head-quartered in Hong Kong, CLSA is a unit of France's Credit Lyonnais banking group with substantial staff ownership. CLSA has over 700 dedicated professionals spread across all Asian and international financial centres. CLSA is consistently recognised as one of the top research, sales and execution houses in Asia and is known for its innovative and independent research. CLSA was recently named the 'Most Independent Research Brokerage House in Asia' for 2002 in both the Asiamoney Brokers Poll and the Asset Equities Benchmark Survey.

aggressively with market capitalization of over US$70 billion. Saudi companies have benefited tremendously from the rapid growth in issuance and general public's enthusiasm in the equity market.

In this chapter, the four guiding mechanisms are identified and promoted as the benchmarks for best practices of corporate governance in Saudi Arabia to which companies should aspire while paying a special attention to the influence of religion (Islam) and culture upon those principles. The related literature is investigated followed by an introduction to the underlying theories: the no-one-size-fits-all theory and agency theory. The hypotheses involved in this research are introduced.

5.2. LITERATURE REVIEW

For ease of reference, the discussion regarding the literature will be divided into two main sections. The first section is a review of the literature relating to the topic of corporate governance in general, which will be divided into two parts: cross-country corporate governance literature and within-country corporate governance literature. The second section is focused on the literature relating to the mechanisms of corporate governance discussed in this thesis, namely: shareholders' rights; board of directors; audit committee and internal audit; and disclosure and transparency.

5.2.1. Literature on Corporate Governance

Much of the empirical literature on corporate governance focuses on a particular aspect of governance, such as board characteristics (Millstein et al., 1998; Bhagat et al., 1999), shareholders' activism (Karpoff et al., 1996; Carleton et al., 1998), compensation to outside directors (Bhagat et al., 1999), anti-takeover provisions (Sundaramurthy et al., 1997), investor protection (La Porta et al., 2002) and so on.

Moreover, most of this empirical literature on corporate governance has linked corporate governance to firm performance using different measures for performance such as Tobin's Q, share prices, market/book common stock ratios, market value of assets/sales, etc. Millstein and MacAvoy (1998) investigated the relationship between board characteristics and firm performance. Karpoff, Malatesta, and Walking (1996) linked firm performance with shareholders' activism. Bhagat, Carey, and Elson (1999) analyzed the relationship between outside directors' pay and firm performance. Sundaramurthy, Mahoney, and Mahoney (1997) linked firm performance with anti-takeover provisions and LaPorta et al. (2002) examined the relationship between investor protection and firm performance.

Some authors have shown that better legal protection for outside shareholders is associated with higher market value and with easier access to external funds in the form of either equity or debt (La Porta et al., 1997), higher valuation of listed firms relative to their assets or changes in investments (Claessens et al. 2002, La Porta et al. 2002, Wurgler 2000), lower private benefits of control (Zingales, 1994; Nenova, 1999) and larger listed firms in terms of their sales and assets (Kumar et al. 1999). Large controlling shareholders have both the incentives and the power to control the management team's actions, management's misbehaviour is a second order problem when such a large shareholder exists. Instead, the main problem becomes controlling the large shareholder's abuse of minority shareholders (Shleifer and Vishny, 1997). Rajan and Zingales (1998) and Demirgüç-Kunt and Maksimovic (1998) found that countries that had better legal protection for investors rely more on external financing to fund their growth.

Although these studies provide valuable insights into the effects of regulatory environments on stock markets, valuation and corporate financing, they do not address firm-level issues such as how corporate governance affects individual firm valuation within a country and do not address the effectiveness of corporate governance.

Recently, a few authors have investigated general corporate governance practices, primarily in emerging markets. Most of them, however, either use a small single-country sample (Black, 2001, and Gompers, Ishii, and Metrick, 2003) or multi-country samples that contain only the largest firms in each country (Durnev and Kim, 2002, and Klapper and Love, 2002). This study is closest to the study by Black, Jang, and Kim (2003) on Korean firms in the sense that both study a full cross-section of all listed firms in the respective markets and both study a developing country. However, it differs in that Black, Jang, and Kim (2003) link corporate governance to firm value, whereas this study investigates the effectiveness of corporate governance in Saudi

Arabia. Also, this study differs from Black, Jang, and Kim (2003) in that this study investigates corporate governance in a developing country where no codes of corporate governance best practices have been adopted.

5.2.1.1. Cross-Country Corporate Governance Literature

In one of the largest surveys across emerging markets, Credit Lyonnais Securities Asia (CLSA) published in 2001 its findings on corporate governance in a report titled "CG Watch: Saints and Sinners – Who's Got Religion?" Credit Lyonnais Securities Asia (CLSA, 2001b) produced corporate governance rankings for 495 firms across 25 emerging markets and 18 sectors. The descriptive statistics presented in the report have shown that companies ranked high on the governance index had better operating performance and higher stock returns. 'Saints and Sinners' studied each emerging market and showed strong correlations between corporate governance and share price performance, valuations and financials. CLSA (2001b) stated,

> In many markets, companies with good corporate governance have out-performed their indices in recent years and move to valuation premia, ... But can that out-performance continue? Yes, it can – if these companies are also higher value creators in their respective markets and sectors. And our research shows that companies with governance are also those with high ROEs and the largest value creators on an EVA analysis (CLSA, 2001b: 1).

Do companies with high corporate governance remain market out-performers? To answer this question, the CLSA released its second corporate governance survey in 2002 entitled, "CG Watch - Make me holy... but not yet!" The CLSA report affirms the truism that companies that have good management also have good share price performance. The report grades companies in Asia as well as those in Latin America and Emerging Europe, Middle East and Africa according to seven key criteria, which measure each company's overall corporate governance. These are discipline, transparency, independence, accountability, responsibility, fairness and social responsibility. The report found that the companies with the highest scores also had the best stock market performance. The top quartile of companies in the corporate governance rankings beat their respective country indices in nine out of ten Asian markets.

CLSA in its third survey (2003) of corporate governance in emerging markets entitled, "CG Watch: Fakin'it - Board Games in Asia," teamed up with the Asian Corporate Governance Association (ACGA) and ranked 380 companies in 10 Asian economies to examine the region's commitment to corporate governance over the long term. The CLSA and the ACGA findings showed general improvement in the regulatory environment and greater efforts being made towards better enforcement in Asia. Overall, investors still need to take action and be wary of corporate shenanigans. The report confirms that corporate governance remains a key to investment decisions and valuation metrics at both the macro-levels and micro-levels. But there is little room for complacency because while there have been improvements, some markets have regressed or remain unchanged. CLSA (2003: 1) stated,

> Over short periods, the out-performance of high-scoring stocks is tenuous. But over the past five years, stocks in the top 25% of the CG survey outperformed their markets by an average of 35 percentage points, while those in the bottom 25% underperformed by 25 percentage points. This performance relationship is clearest in markets where corporate governance is of biggest concern (p.1).

According to CLSA (2003), many of the 380 companies seem more concerned with the appearance of good governance than good governance itself, with many of the survey's high scores contingent on "easy stuff" such as making statements of commitment to better governance and discussing governance in annual reports. The CLSA (2003) report found that the overall environment for corporate governance in Asia has improved markedly over the past year. Most of this improvement has come from changes to the regulatory environment in each Asian market, as opposed to wholesale adoption of good CG by Asian companies.

The Asian and Middle East companies may be "picking up their game" but the depth of their commitment is not yet clear, which is the subject of investigation in this thesis. The corporate governance score for CLSA's universe of companies has on average moved up 4 percentage points to 62%. In all markets, however, cases still abound of egregious transgressions. CLSA (2003) argued that while progress has been made, the real substance behind corporate governance changes within companies was hard to measure. The true test of corporate governance comes when economic conditions are more difficult. It is in times like these when the urgency is greatest for controlling shareholders to use public-listed companies to protect private interest (CLSA, 2003).

Both CLSA and the ACGA agree that nothing can compare with the highest standards of transparency and accountability. According to CLSA (2003), quality of management and boards is the key that ties in companies with good corporate governance together with higher financial ratios and share-price out-performance; and investing in companies with good corporate governance definitely gives investors some protection from the worst blow-ups. Unlike the CLSA (2003) report that concentrates on firms' performance and returns, in this thesis the effectiveness of corporate governance in Saudi Arabia will be assessed and the depth and substance behind corporate governance changes within companies listed in Saudi Arabia will be tested.

Klapper and Love (2002), using CLSA (2001a) rankings, showed that firm-level corporate governance practices matter more in countries with weak legal environments for a sample of 495 large firms in 25 countries. Klapper and Love considered the performance effects of a broad range of governance practices by using the CLSA index that covers six categories (managerial discipline, transparency, independence, accountability, and responsibility) for a sample of firms in 14 countries, most of which are developing economies. Their main findings are that better corporate governance is associated with better performance in the forms of Tobin's Q and return on assets, and that good governance seems to matter more when the legal environment of a country provides investors with weaker protection. This paper by Klapper and Love is one of the important studies on country-level corporate governance.

Durnev and Kim (2002), using Credit Lyonnaise Securities Asia (CLSA) and Standard & Poor's (S&P) rankings, studied the relationship between firm-level corporate governance and valuation. They found that higher scores on both the CLSA corporate governance index and the S&P disclosure and transparency index predict higher firm value for a sample of 859 large firms in 27 countries. They found a stronger relationship in countries with weaker regulatory protection for minority investors.

Johnson et al. (2000) presented convincing evidence that weak legal institutions had an important role to play in exacerbating the currency depreciations and stock market declines in the recent Asian financial crisis. A policy implication of their findings is the mandating of significant improvements in the quality of legal protection available to minority shareholders and other suppliers of external capital.

In a study of a sample of 866 shareholder-initiated proxy proposals on governance issues in 317 publicly traded companies during the period March 1986 to October 1990, Karpoff, et al. (1996) used the event study methodology to answer two questions: What types of companies attract these proposals? How do the proposals affect firm values? In relation to the first question, the authors found that shareholder-initiated corporate governance resolutions tend to target poorly performing firms, as measured by market-to-book ratio, operating returns and recent sales growth. In relation to the second question, they found little evidence of wealth gains that might arise from such improvements. The found that the average wealth effect associated with shareholder-initiated corporate governance proposals was close to, and not significantly different from, zero.

Stijn, Djankov and Lang (2000) investigated the relationship between ownership structure and cash flow rights in a sample of 1857 firms in 22 emerging markets. They found that there was highly concentrated control in their sample. The majority of control rights was held by a single blockholder in one-third of the firms and was held by one or more blockholders in 58 per cent of the firms. Management and their families were the dominant type of controlling blockholder – controlling two-thirds of the firms. Using Tobin's Q to measure firm value, Stijn et al. (2000) found that the firm's value increases with increased concentration of control rights. Higher blockholder cash flow rights are associated with higher firm values, consistent with their hypothesis that large investors have an incentive to monitor management.

La Porta et al. (1998) argued that the common law countries have better minority shareholder protection than the civil law countries. Coffee (1999) noted that the differences in corporate law might be less important than the differences in the level of regulation that different countries impose on their securities markets.

Claessens et al. (2002) and La Porta et al (2002) investigated the relationship between firm value, as measured by Tobin's Q, and ownership structure across different economies. Claessens et al. (2002) studied a large set of firms from eight East Asian emerging economies and found that the cash flow rights held by the largest blockholder are positively related to firm value. Claessens et al. (2002) also found that a difference in the control rights and cash flow rights held by the largest blockholder is negatively related to firm value. LaPorta et al. (2002) studied the 20 largest firms in each of 27 wealthy economies and found that the cash flow rights held by the largest blockholder are positively related to firm value. They found no relationship between Tobin's Q and a separation in the control rights and cash flow rights held by the largest blockholder.

5.2.1.2. Within-Country Corporate Governance Literature

5.2.1.2.1. Developed Countries

Most of the empirical literature on corporate governance has focused on the relationship between corporate governance and performance. However, in the Saudi Arabia case, it is too early to link corporate governance to the firm performance because corporate governance in Saudi is still developing. Moreover, Saudi Arabia has not adopted any international recommendations or principles and, furthermore, Saudi has not yet produced its own best practices of corporate governance. Corporate governance in Saudi Arabia seems to be weak and the focus at this stage should be towards assessing corporate governance practices, helping regulators, organizations and corporations in understanding what has been meant by corporate governance and providing the Saudi economy with some recommendations to develop corporate governance.

It is worth emphasizing the importance of corporate governance in other countries and learn from them. In the USA, several researchers investigated the relationship between corporate governance and performance (e.g., Bhagat and Brickley, 1984; Bhagat and Jefferis, 1991; Morck et al., 1988; Karpoff, 1998; Gompers et al., 2003). Most of these studies, however, show mixed results with the exception of Gompers et al. (2003) who found that corporate governance provisions related to takeover defences are significantly related to firm valuation (Durnev and

Kim, 2002). Black (2001, p. 1) stated, "Most tests of whether variations in corporate governance behaviour between U.S. firms affect firm value find either no effect or a relatively small effect".

CalPERS, America's largest public pension fund, found that the 42 companies CalPERS targeted for improvement in corporate governance practices out-performed the Standard & Poor's 500 Stock Index by 52.5 per cent in the five-year period following CalPERS' involvement (1987 to 1992), whereas these same companies had trailed the index by 66 per cent during the five years before CalPERS' involvement. Even though these are very significant figures, it is hard to know how much of the stock price improvement can be causally attributed to CalPERS' involvement and more effective governance.

McKinsey (2000) explored whether a monetary value could be placed on good governance. The definition of good governance in this study was defined as having a majority of outsiders on the board; having independent directors with no management ties and who own a significant amount of the stock of the company; who are remunerated to a large extent by stock and who are formally evaluated; and lastly, who are responsive to investor requests. The study found that investors are willing to pay an average premium of 11 percent for companies they perceive as having good corporate governance. It is important to note, however, that the results of this study do not demonstrate the effects of best practices on firm performance as such. The results demonstrate the effects of investors' perceptions of the existence of best practices, on a specific measure of performance, stock price. They are also based on what investors say they would do, not what they actually do, which can diverge considerably.

McConnell et al. (1990) investigated the relationship between Tobin's Q and ownership of US firms (two samples were used: 1,173 firms for 1976 and 1,093 firms for 1986). They found that there was a curvilinear relationship between Tobin's Q and insider ownership. The curve first slops upwards to reach a maximum at an insider ownership of about 40 to 50 per cent and then slops slightly downwards. They found a positive relationship between firm value and institutional ownership. However, the relationship was only able to explain three per cent of the cross-sectional variation in performance in 1976 and only six per cent in 1986.

Slovin and Sushka (1993) investigated the influence of the death of inside shareholders on the value of the firm for a sample of 85 companies. They found that the two-day abnormal return (i.e., the cumulative abnormal return for the day preceding the announcement of the death of an insider plus the day of the announcement) is highest if the deceased shareholder held between 20 and 30 per cent of the equity. If the deceased held between 5 and 10 per cent only, they did not find any effect at all on the stock return.

Holderness and Sheehan (1988) examined 114 quoted US firms in the period from 1978 to 1984 having a shareholder owning at least 50 per cent of the equity. They looked at the share price reactions to sales of majority stakes. Buyers and sellers of majority blocks are partitioned into individuals and corporations. They found some weak evidence (p-value = 0.07) of a high abnormal return if the seller was an individual.

In the United Kingdom, Frank et al. (1997), in a sample of 243 UK firms drawn randomly from all the listed UK firms (excluding banks, insurance companies and real estate firms), investigated the relationship between the board turnover and the firm's financial performance. They found that there was an active market in blocks of shares. Those sales were associated with major changes on the boards but not with bad financial performance. They also found that there was at best a weak relationship between outside ownership and board turnover.

In Germany, Cable (1985) tested the hypothesis that bank ownership and control has an influence on the financial performance of a sample of the 100 largest German firms in 1970. He found a significant positive relationship between the degree of banks' involvement and the level of profitability. Gorton and Schmid (1996) analysed two cross-sections of large German firms with 88 observations for 1974 and 57 observations for 1985. They found that firms with a higher concentration of ownership did have a better financial performance in 1985, but no such relationship existed for 1974. Kaplan (1994) and Frank and Mayer (1996) studied the relationship between financial performance, board turnover and ownership in Germany. They all agreed that there was no influence of bank ownership on board turnover of badly performing firms.

In France, Charreaux (1997) performed a test on a sample of French companies using six different measures of performance and nine measures of governance characteristics in his model. He, however, found that performance was not explained by those governance characteristics. Charreaux also replicated the Morck et al. (1988) model using Tobin's Q as the measure of performance. However, he again found no link between firm value and the governance characteristics he used.

5.2.1.2.2. Developing Countries

In Korea, Black, Jang and Kim (2003) reported that corporate governance is an important factor in explaining the market value of Korean public companies. The authors constructed a corporate governance index for 526 companies based primarily on responses to a Spring 2001 survey of all listed companies by the Korea Stock Exchange. The index is based on five sub-indexes for shareholder rights, board and committee structure, board and committee procedures, disclosure to investors and ownership parity. They found that a moderate 10-point increase in the corporate governance index predicts a 6 percent increase in Tobin's *q* and a 14 percent increase in market/book ratio. A worst-to-best change in the index predicts a 42 percent increase in Tobin's *q* and an 87 percent increase in market/book ratio.

In Russia, Black (2001) examined the relationship between corporate governance behaviour and market value for a sample of 21 Russian firms. He reported a powerful negative correlation between the market value and corporate governance. A worst-to-best improvement in governance predicted a 700-fold (70,000%) increase in the market value of a Russian firm as a percentage of theoretical Western market value. However, Black's (2001) sample is small, 21 firms. This study suggests that firm-level governance is more important than ever in countries where legal protections are weak. In less-developed markets, companies can distinguish themselves through the rules and governance procedures they adopt.

5.2.2. Literature on the Mechanisms of Corporate Governance

5.2.2.1. Literature on Shareholders' Rights

As noted by Core, Holthausen and Larcker (1999), collective evidence from the literature on shareholder rights is mixed, especially those who have linked the rights of shareholders to the firm performance. They failed to provide a coherent picture of that relationship.

Authors have shown that better legal protection for outside shareholders is associated with higher market value and with easier access to external funds in the form of either equity or debt (La Porta et al., 1997), higher valuation of listed firms relative to their assets or changes in investments (Classens et al. 2002, La Porta et al. 2002, Wurgler 2000), lower private benefits of control (Zingales, 1994; Nenova, 1999) and larger listed firms in terms of their sales and assets (Kumar et al. 1999).

Holderness and Sheehan (1988) investigated the impact of ownership structure on performance of firms in the US. They found little evidence that high ownership concentration directly affects performance. They also found no significant differences in accounting rates of return or Tobin's Q between their sample of majority-owned U.S. firms and paired firms with diffused ownership. Morck, Shleifer, and Vishny (1988) provided an illustration of the theoretical trade-off between incentives and entrenchment. The authors showed that firm performance, as measured by Tobin's Q, is non-monotonic to management ownership concentration. It increases at low levels of concentration and then decreases at moderate levels. Gorton and Schmid (2000) found that performance of German firms, measured by market-to-book value of equity, was increasing in both the concentration of control rights from equity and banks' control rights from equity. Lichtenberg and Pushner (1994) found that greater concentration of ownership by financial institutions is positively related to productivity and profits among Japanese firms, which they attribute to the monitoring and intervention employed by these institutions.

Shleifer and Vishny (1997) suggested that the potential takeover threats from large shareholders serve as effective monitoring devices, and that this reduced the firm's agency cost and improves operating performance. On the other hand, large shareholders have incentives to redistribute wealth to themselves, by indulging their private interests to the detriment of others. Mikkelson and Ruback (1985) and Holderness and Sheehan (1985) found positive excess returns around the announcement date when outsiders assume a large equity position. However, Holderness and Sheehan (1988) found no significant differences in Tobin's Q and accounting rates between firms where a controlling shareholder (owning 50% or more) exists and those where no shareholder owns more than 20%. McConnell and Servaes (1990) examined Tobin's Q for a sample of firms for 1976 and 1986. They reported little relationship between inside ownership and firm value but found no effect of external shareholders. Mehran (1995) examined Tobin's Q and accounting profits (ROA) for 153 firms during 1979-80 and reported no impact of shareholders on either measure of performance.

5.2.2.2. Literature on Board of Directors

Investigators of Boards of directors have explored numerous Board characteristics including the number of directors on the Board, the percentage of outside directors on the Board, the ownership position of inside directors, Board committee structure, and the number of meetings held annually (Hermalin and Weisbach, 2000; Bhagat and Black, 1999; and Shultz, 2000). However, relatively few academic studies investigated how these characteristics enhance the effectiveness of the Board of directors.

Although the proportion of non-executive directors to executive directors is an important feature of Board structure, there are mixed results in the literature. Fama and Jensen (1983) argued that it is natural for the most influential members of the Board to be executive management because of their privilege of information. Williamson (1984) noted that because executive management does have information advantage due to their full-time status and insider knowledge, the Board of directors might become an instrument of executive management. Fama (1980) contended that domination of the Board by top management might lead to collusion and a transfer of shareholder wealth to management. The relationship between Board composition and firm value has also been addressed by a number of researchers (e.g., MacAvoy et. al., 1983, 1999; Morck et. al., 1988; Hermalin and Weisbach, 1991; Mehran, 1995; Klein, 1998; Yermack, 1996; Agrawal and Knoeber, 1996; Baysinger and Hoskisson, 1990;

Hermalin and Weisbach, 1991; Burton, 2000; and others). However, these authors have shown mixed results.

Ryan and Wiggins (2003) examined the relationship between the structure of outside director compensation and Board-of-director independence. They considered the relationship between the structure of director compensation and Board size, the percentage of outside directors on the Board, CEO tenure, and CEO/Chair duality. The evidence indicated a positive relationship between characteristics associated with an independent Board and director compensation that is tied to stock-price performance. If barriers to monitoring are prevalent in a firm, then director compensation provides weaker incentives. Directors of firms in which the CEO is entrenched receive the fewest financial incentives to monitor.

Kesner and Dalton (1986) contended that the ability of the Board to perform effectively is related to the lack of independence from the management it is meant to control. The separation of the role of CEO and Chairman is often advanced as a means to prevent domination of the Board by a powerful chief executive and top management.

Non-executive directors are considered to be in a better position to play a monitoring and controlling function as opposed to executive management due to their independent nature. Research on the ability of non-executive directors to determine compensation (Core et al. 1997) may suggest otherwise. Vance (1983) argued that non-executive directors are more likely to be obligated to the CEO for their position and are, therefore, less likely to challenge and oversee executive management aggressively.

Much of the literature has also linked Board characteristics to firm performance. Yermack (1996) provided evidence of a negative relationship between the size of the Board and firm performance. However, Hermalin and Weisbach (1991, 2003) found no significant relationship between Board composition and performance. Yermack also showed that the percentage of outside directors did not significantly affect firm performance. MacAvoy et al. (1983), Hermalin and Weisbach (1991), Mehran (1995), Klein (1998) and Bhagat and Black (2000) all reported an insignificant relationship between corporate Board independence and accounting performance, while Morck et al. (1988), Hermalin and Weisbach (1991), Bhagat and Black (2000), Burton (2000) and Baysinger and Hoskisson (1990) found no relationship between Board independence and firm value using Tobin's Q as a measure of firm value. In studies examining U.S. firms, there is little evidence for the existence of a consistent cross-sectional relation between Board composition and firm value.

Yermack (1996) and Agrawal and Knoeber (1996) found a negative correlation between Tobin's q and the proportion of independent directors on the Board. However, their results do not hold across performance measures. Bhagat and Black (1998) reported a similar negative relationship, but they showed that it holds for a variety of performance measures over a period of years. In contrast, Baysinger and Hoskisson (1990) found no relationship between Board composition and performance. Hermalin and Weisbach (1991) compared the percentage of outsiders on Boards to a relative measure of Tobin's q and found no relationship between the percentage of outsiders on the Board and firm value. Bhagat and Black (2000) found no relationship between long-term market returns and Board independence. Burton (2000), reviewing the literature, found no robust empirical support for the belief that Boards that are "structurally independent" of management lead to better performance; rather, they may be associated with inferior performance.

Rosenstein and Wyatt (1990) used event-study methodology and found a very slight increase in stock prices when a company appointed an additional outside director. However, the same authors (Rosenstein and Wyatt, 1997) seven years later found that the appointment of an additional inside director had no significant effect on share prices. Shivdasani and Yermack (1998) found a positive market reaction to the appointment of non-executive directors if the CEO had not been involved in the appointment and a negative reaction if the CEO had been involved in the appointment. Baysinger and Butler (1985) tested the relationship between the percentage of independent directors and return on equity. They found that Boards with more outside directors out-performed other firms but that a majority of independent directors was not necessary to insure above average value. Baysinger and Butler conclude that Boards with both insiders and outsiders produce the best financial value.

In an effort to find a relationship between incentive compensation contracts and firm value, Mehran (1995) documented a positive relationship between the percentage of CEO compensation that is equity-based and both Tobin's *Q* and return on assets, controlling for CEO ownership and the percentage of outside directors. Brickley, Bhagat and Lease (1985) found that stock prices respond positively to the adoption of long-term equity-based compensation plans.

Researchers also have investigated the role of experienced directors in the firms' performance. Koontz (1967) and Juran et al. (1975) considered that many corporate Boards had too many older, less productive, Board members. Vance (1983), however, argued that a positive correlation exists between financial performance and the average age of directors as a result of greater experience. Research to date on the issue of age is therefore inconclusive. Furthermore, the existence of a positive/negative correlation between director age and financial performance must be considered alongside other factors such as director skills, the complexity of the business and the environment in which the business operates.

Like Morck et al. (1988), Mehran (1995) and Black et al. (2003), other authors have used Tobin's Q as a performance measure. Hermalin and Weisbach (1991) and Bhagat and Black (2000), as examples, used Tobin's Q and found that there is no noticeable relationship between the proportion of outside directors and Tobin's Q. Bhagat and Black (2000) examined the effect of Board composition on long-term stock market and accounting performance. However, they did not find any relationship between Board composition and firm performance.

Baysinger and Butler (1985), on the other hand, found that the 1970 proportion of independent directors is positively related to 1980 return on equity. However, as Bhagat and Black (1999) emphasized, these authors used only a single performance measure and ten years seems like an implausibly long time over which to observe performance improvements from a factor such as Board composition.

MacAvoy and Millstein (1999) argued that mixed results have followed from concentrating on periods when Boards were largely irrelevant and using unreliable proxies for Board independence. They argued that one reason why researchers have generally failed to detect a relationship between measures of Board characteristics and firm performance is that they have used "old" data – that is, data that preceded Boards taking an activist role. MacAvoy and Millstein found evidence that CalPERS' grading of Board procedures is positively correlated with accounting-based measues of performance. They used two measures of activism developed by CalPERS as an indication of Board independence and Economic Value Added as the measure of financial value. MacAvoy and Millstein found a positive relationship between Board independence and financial value. The results are obviously mixed and Hermalin and Weisbach (2000: p.13) argued that "Overall, there is little to suggest that Board composition has any cross-sectional relation with firm value."

The lack of a clear relationship between performance and Board characteristics in the literature may result from the multiple roles played by a Board. In addition to its monitoring role, a Board is also a source of expertise on legal, strategic and other decisions. Hermalin and Weisbach (1988) also suggest that Boards serve as a means of grooming potential CEOs.

Scott and Kleidon (1994) studied the relationship between chief executive turnover and firm performance and found that firms with a majority of non-executive directors that replace CEO tend to have worse pre-replacement share prices than firms with executive-dominated Boards. Morck et al. (1988) showed that Boards could remove top managers as a result of poor performance. Weisbach (1988) also noted that Boards dominated by non-executive directors were more likely to dismiss top management as a result of poor corporate performance.

Klein (1998) investigated whether the existence of a Board committee affects firm performance and found no evidence to suggest that performance is improved where a greater number of non-executive directors are on the Board. She found no relationship between the proportion of directors with additional directorships for accounting and market measures. Bhagat and Black (1999) disputed this argument as they found that a direct weak relationship exists between Board composition and firm performance.

5.2.2.3. Literature on Audit Committees and Internal Audit

Researchers have indicated a great deal of variation in both perceived and stated responsibilities of audit committees (e.g., Abdolmohammadi and Levy, 1992; Coopers and Lybrand, 1995; DeZoort, 1997; Kalbers, 1992a) and the need better to understand responsibilities to improve the effectiveness of audit committees (e.g., Rittenberg and Nair, 1993). Coopers et al. (1995) argued that the scope of audit committee activity had expanded considerably over the two decades. They found that most of the audit committees conducted a wide range of oversight duties.

Pincus et al. (1988) noted that audit committees enhance the board's capacity to act as a management control by providing a more detailed knowledge and understanding of the financial statements and other financial information issued by the organization. Lee and Stone (1997) studied 100 U.S. multi-national companies and found a "mismatch" between audit committees' stated responsibilities and the levels of instrumental experience (defined as skills related to accounting, auditing, and control issues) among members. Lee and Stone (1997) indicated a mismatch between stated audit committee responsibilities and the level of audit committee member instrumental experience (i.e., skills in accounting, auditing and control issues).

A great deal of research has been undertaken to date about audit committees and internal audit. However, most of this research has been concerned with linking audit committees to firm performance and only a few studies have investigated the effectiveness of audit committees. Wild (1994) found that the market reacted more favourably to earnings reports after an audit committee had been established. Klein (1998) found that the presence of an audit committee had no effect on a range of accounting and market performance measures. She also found that changes to the composition of the audit committee did not generate abnormal returns. Vafeas and Theodorou (1998) also found no evidence to support the view that the structure of Board sub-committees significantly affected performance. Klein (2002) found that audit committee independence was negatively associated with abnormal accruals and that reductions in audit committee independence were associated with large increases in abnormal accruals.

Fried (1976) noted that the pre-occupation with the form of audit committees was not conducive to evaluating the effectiveness of audit committees. Beasley (2000) considered the key structural elements of audit committees in "fraud" as compared to "no-fraud" firms. It was found that whilst both types of firm had audit committees, the structure of the "fraud" firms' audit committee was unsatisfactory.

5.2.2.4. Literature on Disclosure and Transparency

Disclosure and transparency have been noted to play an important role in the corporate governance system of firms (Bushman and Smith, 2000). Gelos et al. (2002) examined whether country transparency affects international portfolio investment or not using new measures of transparency and a unique micro-data set on international portfolio holdings of emerging market funds. They distinguished between government and corporate transparency. There was clear evidence that funds invest systematically less in less transparent countries. Herding among funds tends to be more prevalent in less transparent markets. Funds seemed to react less strongly to macro-economic news about opaque countries. There was also some evidence that during crises, funds flee non-transparent countries to a greater extent.

Most of the studies in the empirical disclosure literature focus on the relationship between voluntary disclosure and the cost of capital. In these studies the authors typically focus on the relationship between disclosure quality and the bid-ask spread. However, the evidence presented in these studies is mixed. Leuz et al. (2000), Healy et al. (1999) and Welker (1995) provided evidence of a negative relationship between the bid-ask spread, measure of the cost related to information asymmetry, and disclosure as is predicted by the theory. On the other hand, Botosan et al. (1998) and Monahan et al. (2001) provided evidence of an insignificant association between the spread and disclosure. Healy et al. (1999), investigating changes in disclosure levels, found that firms increasing their disclosure lower their spreads (as well as experience additional benefits that might be the result of good performance). Leuz et al. (2000) found that German firms committing to a higher disclosure level experience lower bid-ask spreads and higher trading volume. However, spreads and volume are at best indirect evidence of a higher firm value.

Botosan (1997) and Botosan et al. (1999) examined the relationship between disclosure and the ex-ante cost of capital. They found that there was a negative relationship between the increased disclosure level and the cost of equity capital. Welker (1995) found that firms with high disclosure scores have lower bid-ask spreads (a proxy for the information asymmetry component of the cost of capital). Sengupta (1998) reported that firms disclosing more have lower costs in issuing debt. Gelb (1999) also found that information costs are lower for firms that provide more informative disclosures, based on their choice of stock repurchases as a means for one-time cash distributions. Citing this body of evidence to support the importance of disclosure, Standard & Poor (2001) launched an ambitious survey of transparency and disclosure covering 1,600 companies around the world.

Therefore, it could be seen from these studies that disclosure may increase firm value in different ways. One of them is by ameliorating the adverse selection problem faced by uninformed traders. In the presence of information asymmetry, market intermediaries will increase the bid-ask spread (Copeland and Galai 1983, Glosten and Milgrom 1985). If the marginal investor faces a non-trivial likelihood of experiencing a future liquidity shock, these actions by the market maker lead to an increase in the firm's cost of capital (Amihud and Mendelson 1986). Firms can reduce this illiquidity premium, which is often referred to as the information asymmetry component of the cost of capital, by committing to an increased level of disclosure quality (Diamond and Verrecchia 1991, Verrecchia 2001).

5.2.3. Contribution to Knowledge

This study differs from related research in several ways: by investigating the effectiveness of corporate governance; firm-level issues; all listed Saudi firms; no typical institutions (outside influences) of corporate governance; and religion effects.

First, most of the empirical literature on corporate governance has focused on the relationship between corporate governance and performance (Goergen, 1998; La Porta et al., 2000; Claessens, 1997; Karpoff, et al. 1996; Johnson et al. 2000; Durnev and Kim, 2002; Klapper and Love, 2002; Bhagat and Jefferis, 1991; Gompers et al., 2003; McConnell, 1990; McKinsey, 1999; Frank et al. 1997; Black 2001; Holderness and Sheehan, 1988; and Shleifer, 1997), shareholder rights and performance

(Holthausen et al., 1999; Claessens et al. 2002; Zingales, 1994; Nenova, 1999; Lichtenberg et al., 1994), Board of directors and performance (MacAvoy et. al., 1983, 1999; Morck et. al., 1988; Hermalin and Weisbach, 1991; Mehran, 1995; Klein, 1998; Bhagat; Black, 2000; Yermack, 1996; Agrawal and Knoeber, 1996; Baysinger and Hoskisson, 1990; Hermalin and Weisbach, 1985; and Burton, 2000), audit committee and performance (Wild, 1994; Klein, 2002; Vafeas and Theodorou, 1998) and disclosure and transparency and performance (Leuz et al. 2000; Healy et al. 1999; Welker, 1995; Copeland and Galai 1983, Glosten and Milgrom 1985).

However, few studies in the literature have investigated the effectiveness of corporate governance and its elements discussed in this study, namely: shareholder rights, board of directors, audit committee and disclosure and transparency. In the Saudi Arabia case, it was thought to be too early to link corporate governance to firm performance because corporate governance in Saudi is still developing. Moreover, Saudi Arabia has not adopted any international recommendations or principles, and furthermore, Saudi has not yet produced its own best practices of corporate governance. Corporate governance in Saudi Arabia seems to be weak and the focus at this stage should be towards assessing corporate governance practices, helping regulators, organizations and corporations in understanding what it has been meant by good corporate governance and providing the Saudi economy with some recommendations to develop and enhance corporate governance.

Second, previous authors have shown that better legal protection for investors is associated with higher valuation of listed firms relative to their assets or changes in investments (Claessens et al., 2002; La Porta et al., 2002; Wurgler, 2000), higher market value (La Porta et al., 1997) and larger listed firms in terms of their sales and assets (Kumar et al., 1999). Rajan and Zingales (1998) and Demirgüç-Kunt and Maksimovic (1998) also found that industries and firms that had better legal protection for investors rely more on external financing to fund their growth. Although these studies provide valuable insights into the effects of regulatory environments on stock markets, valuation and corporate financing, they do not address firm-level issues such as how corporate governance affects individual firm valuation within a country and they do not assess the effectiveness of corporate governance mechanisms.

Third, the data source for this study is all listed Saudi firms, both large and small, which enhances the generalizability of this study. The other researchers on emerging markets, however, either use a small single-country sample (Black, 2001) or multi-country samples that contain only the largest firms in each country (Durnev and Kim, 2002; Klapper and Love, 2002).

Fourth, the most widely known guidelines and principles of corporate governance are those developed by three international organizations, namely, the World Bank, the International Monetary Fund (IMF) and the Organization for Economic Co-operation and Development Principles of Corporate Governance (OECD) (PCSU, 2000). Countries adopting corporate governance rules more or less follow the standards set by those organizations. However, Saudi Arabia is not one of these countries and does not adopt or follow any of these organizations. Although some authors have investigated corporate governance in developing markets, this study will be the first to investigate how good corporate governance is in a developing country that does not adopt the corporate governance principles and does not have typical institutions (outside influences) of corporate governance.

Finally, this study could be classified as the first study investigating how religion (Islam) affects the adoption of such principles.

5.2.3.1. Statement of Significance

The last twelve years have seen significant growth in the Saudi economy, especially the stock market (Al-Jasser, 2002), which, in turn, enhances the importance of this study which, it is hoped, will help Saudi firms to adopt and implement corporate governance principles and rules. The number of shares traded in Saudi Arabia increased by over 3,979 percent from 1990 to 2002 and the value of shares traded increased by more than 1,799 per cent. Over 2.4 million individuals have invested in shares of Saudi Arabian joint stock companies, that is, over 10 per cent of the national population and the market capitalization of the stock market amounted to SR286 (US$1.00 = SR3.75) billion at the end of first quarter of 2002 (Al-Jasser, 2002). Those shareholders and others may be interested in knowing the results of this study because shareholders reap the rewards from good corporate governance (Monks, 2001).

5.3. THE PRIMARY THEORIES UNDERLYING THE RESEARCH

5.3.1. No-One-Size-Fits-All

Hollingsworth et al. (1994: 7) provided an example of a "no-one-size-fits-all" perspective:

> Transactions are conducted on the basis of mutual trust and confidence sustained by stable, preferential, particularistic, mutually obligated, and legally non-enforceable relationships. They may be kept together either by value consensus or resource dependency – that is, through 'culture' and 'community' – or through dominant units imposing dependence on others.

This statement was made in the context of transactions being governed by networks at the "meso-level, e.g., the intermediate location between the micro-level of the firm and the macro level of the whole economy," rather than of the firm (Hollingsworth et al. 1994: 9).

La Porta et al. (1997) found that the type of dominant religion in a culture can affect trust. They found that trust in large organizations increases as the proportion of the population involved in hierarchical religions, like Catholicism, decreases. While Japan showed an above average degree of trust, it was not as high as Nordic countries and China.

While the "one-size-fits-all" (Robinson, 2001; and Cha, 2002) approach may be both unattainable and unrealistic, it is fortunately possible to identify and promote a set of guiding principles as the benchmark for best practices in corporate governance to which companies should aspire (Robinson, 2001). However, the influence of religion upon corporate governance in Saudi Arabia limits the potential of the generalization of those principles. Based on the *Shari'a*, Islam has formulated a comprehensive ethic governing how business should be run, how corporate governance ought to be undertaken and how banking and financing is to be arranged. All of these components impose a unique challenge to Islamic corporate governance.

One purpose of this study is to scrutinize the corporate governance principles promoted by the World Bank, International Monetary Fund (IMF) and Organization for Economic Co-operation and Development (OECD). Then, to interlink them with the comprehensive Islamic laws and philosophy since Islam is part of the Saudis' ethics and regulations. Finally, recommendations for good, Islamic, Saudi corporate governance will be concluded.

A system of corporate governance is concerned with the checks and balances on the exercise of power. Corporate governance varies between countries as a result of differing ideologies, histories, politics, beliefs, social and economic factors. It is therefore, not possible to impose one uniform system of governance across the board (Figure 5.1).

5.3.2. Agency Theory

Tricker (1996: 31), stated:

> Stewardship theory, stakeholder theory and agency theory are all essentially ethnocentric. Although the underlying ideological paradigms are seldom articulated, the essential ideas derived from Western thought, with its perceptions and expectations of the respective roles of individual, enterprise and the state and of the relationships between them.

Corporate governance is a system of external and internal control mechanisms that allows the owners to control activities of the firm, especially the activities of their managers (Dzialo et al., 1998). Tannenbaum (1962) defined control as any process in which a person or group of persons or organization of persons determines; i.e., intentionally affects, what another person or group or organization will do. This definition provides a word to describe a situation where no standard of performance is required. Etzioni (1965) and Downs (1967) use the word control in the sense of meeting some standard of performance. Thus, control infers that a person possesses the power to determine what actions are taken.

Theoretical and empirical research on corporate governance was originally motivated by the separation of ownership from control (Berle and Means, 1932) and, more recently, by agency theory (Jensen and Meckling, 1976; Fama and Jensen, 1983). The need for a corporate governance system results from the separation of ownership and control (Dzialo et al., 1998). Managers may use their position to protect their own interests and not take care of the interests of the firm's owners.

Researchers in this area are concerned with only one aspect of agency theory – the separation of ownership from control (see Berle and Means, 1932; Monks and Minow, 2001; Dzialo et al., 1998; Jensen and Mechling, 1976; Oliver, 1995; Morck, Shleifer and Vishny, 1988). In particular, most studies have highlighted two potential agency problems associated with corporate governance. The first is the management-shareholders conflict, which arises when shareholders are so numerous and dispersed that no one is able or willing to monitor the management, leaving the management relatively unconstrained to pursue their own interests (Berle and Means, 1932; Jensen and Meckling, 1976; Morck, Shleifer and Vishny, 1988). The second agency problem arises when one shareholder has effective control of the firm and thus can take actions that benefit him/her at the expense of the non-controlling or minority shareholders (Shleifer and Vishny, 1997).

Berle and Means (1932) argued that when shareholders are too diffuse to monitor managers, corporate assets could be used for the benefit of the managers rather than for maximizing shareholders' wealth. In other words, the more dispersed the ownership equity of a firm the greater the incentives for the owners to free ride on each other's efforts to monitor management. Realizing the significance of corporate power, Berle and Means (1032) observed that:

> The rise of modern corporations has brought a concentration of economic power which can compete on equal terms with the modern state – economic power versus political power, each strong in its own field. The state seeks in some aspects to regulate the corporation, while the corporation, steadily becoming more powerful, makes every effort to avoid such regulation... the future may see the economic organism, now typified by the corporation, not only on an equity plan with the state, but possibly even superseding it as the dominant form of social organisation (Berle and Means, 1932, rev. edn, 1967:313).

Aoi (1997) argued that corporate governance does elicit the question: to whom does the company belong? In other words, who controls our corporations today? Are they controlled by Boards of directors, managers or shareholders? Therefore, control has been and is becoming a central focus of governance.

Oliver (1995) argued that corporate governance issues arise in an organisation whenever two conditions are presented. First, there is an agency problem, or conflict of interest, involving members of the organisation – these might be owners, managers, workers or customers. Second, transaction costs are such that this agency problem cannot be dealt with through a contract.

Moreover, the theory proposed by Jensen and Meckling (1976) suggests that managers' incentives to maximize the shareholders' value increase as their ownership stake rises, because as owners they have fewer incentives to consume perquisites and waste the firm's resources. Therefore, agency theory points to insider shareholdings as another internal mechanism to control conflicts between managers and owners, and improve performance.

In this study, the agency problem has been viewed in a comprehensive way that involves four key players in a company, namely: board of directors; chief executive officers; shareholders; and audit committee members (Figure 5.1). Because conflict (agency problem) exists between these groups, the researcher expects a difference in their perspectives to corporate governance mechanisms. The relationship between each player and each mechanism of corporate governance and the agency problem is discussed in the following section (Section 5.4).

5.4. HYPOTHESES DEVELOPMENT

5.4.1. Shareholder Rights and Agency Theory

In order to attract global risk capital, many jurisdictions are moving to stronger protection of shareholders. When ownership is separated from management, a basic question for shareholders is how they can effectively monitor managers and exercise control so that the managers will act in the shareholders' best interest.

A number of mechanisms exists for shareholder monitoring and control. The most important are the system of the Board of directors, shareholder participation through voting during shareholder meetings, performance-related executive compensation, legal protection of shareholder rights and transparency and disclosure requirements. These mechanisms are mostly embedded in corporate laws and other legislation. When ownership is concentrated in a firm, for example, there are potential conflicts of interest between the dominant shareholders and dispersed minority shareholders, that is, controlling shareholders may mistreat or expropriate minority shareholders' rights.

Corporate governance literature has devoted a great deal of attention to the ownership structure of corporations. Shareholders of publicly held corporations are so numerous and small that they are unable to control the decisions of the management team, and thus cannot be assured that the management team represents their interests (Berle and Means, 1932). However, many solutions to this problem have been considered by several authors, e.g., the disciplining effect of the take-over market (Grossman and Hart, 1980), the positive incentive effects of the management shareholding stake (Jensen and Meckling, 1976) and the benefits of large monitoring shareholders (Shleifer and Vishny, 1986).

Therefore, shareholder rights as a mechanism of corporate governance could be a method of mitigating agency problems, either through direct reduction of the separation of ownership from control, or through the concentration of monitoring incentives on outside investors. In the first case, managers hold a substantial equity stake, which causes them to come closer to internalizing changes in shareholder value. In the second case, some investor holds enough equity to overcome the free-riding problem of dispersed ownership with respect to monitoring management. However, with concentrated ownership comes the danger of managerial entrenchment or the expropriation of minority investors, since large shareholders have the ability to select directors and resist proxy contests and tender offers (Ishii et al. 2002).

Other authors, on the other hand, like Bhide (1994), argued that the alienation of shareholders and managers could make public equity markets an unreliable source of capital. According to him, in order to make truly fair evaluations, shareholders must maintain candid on-going dialogue with managers. The degree of closeness of manager-shareholder relationships has a significant influence on the governance of companies. The basic nature of executive work calls for an intimate relationship. However, arm's-length shareholders cannot provide good oversight or counsel, a condition which often evokes mistrust and hostility.

Therefore, as regards the first element/mechanism of corporate governance – shareholders' rights – the null hypothesis is as follows.

H_o (1): Differences observed in the mean scales of the four categories of participants (board of directors' members, chief executive officers, audit committee members and shareholders) – with respect to the shareholders' rights – are statistically insignificant in Saudi joint stock corporations.

This hypothesis is statistically formulated as follows.

$H_{o\,SHR}$: $\mu_{board} = \mu_{ceo} = \mu_{audit} = \mu_{share}$ $H_{I\,SHR}$: $\mu_{board} \neq \mu_{ceo} \neq \mu_{audit} \neq \mu_{share}$

Note		
	μ_{board}	Mean of sample1 (board of directors)
	μ_{ceo}	Mean of sample2 (chief executive officers, CEO)
	μ_{audit}	Mean of sample3 (audit committee members)
	μ_{share}	Mean of sample4 (shareholders)
	$H_{o\,SHR}$	Null hypothesis in respect to shareholders rights
	$H_{I\,SHR}$	Alternative hypothesis in respect to shareholders rights

5.4.2. Board of Directors and Agency Theory

A properly constituted board of directors, which is independent from management (Jensen and Meckling, 1976; Williamson, 1985; Kesner and Dalton, 1986; Davis and Donaldson, 1994), may effectively monitor the management. Kenser and Dalton (1986: p.17) stated:

> What would happen if the president of the U.S. were also Chief Justice of the Supreme Court? And half the remaining justices were members of the President's staff? Our system of checks and balances would obviously be dealt a deathblow. But isn't an analogous, unsettling scenario being played out in some corporations?

The role of outside directors is emphasized with respect to Board independence. Fama (1980), Fama and Jensen (1983), and others argued that Boards dominated by inside directors are more difficult to control and regarded the practice as undesirable because it gave one person too much power within the decision-making process. Their argument is that including outside directors as professional referees enhances the viability of the Board and also reduces the probability of top management colluding to expropriate shareholder wealth. However, there is no general consensus on the perceived benefits of outside directors. For instance, Crystal (1991) and Mace (1986) agreed that since outside directors are essentially hired by the CEO, they are unlikely to assume an adversarial position to the CEO. Byrd and Hickman (1992) noted that a clever CEO might hire more outside directors to give shareholders a false impression of having a high-quality governance system. Therefore, a Board can be rendered ineffective when management overrides the Board's monitoring responsibility, influences the selection of outside directors, controls meetings and agendas and delivers inside information to certain members.

The two biggest corporate failures of recent times, Enron Corp. and WorldCom, raised concerns about the lack of vigilant oversight. Enron's Board, as an example, allowed the creation and operation of special-purpose entities designed to over-state earnings and assets and under-state liabilities (Rezaee, 2003).

The American Law Institute (1982) and Dunn (1987) argued that Boards generally fail in their responsibilities to monitor management and guide their companies; and they have called for regulations requiring Boards to be composed of a majority of outsiders. Dahya et al. (1996) found that the UK stock market reacted favourably to the separation of management and control. Dahya also found that companies that do not separate management from control performed worse on the market.

Mace (1972), in a study based on research with many US companies, sought to discover what directors really did and challenged the conventional wisdom.

> In most companies boards of directors serve as a source of advice and counsel, serve as some sort of discipline... I found that most presidents and outside board members agree that the role of directors is largely advisory and not of decision-making nature... Outside directors are especially helpful in the advisory role where their general or specialized backgrounds and experiences can be applied to the specific management problems of the company served...Sometimes, but not too frequently, the advice and counsel of a board member leads to a reconsideration or modification of a management's commitment or decision. Occasionally, but only very rarely, the advice and counsel of a board member leads to a reversal of a management commitment decision (Mace, 1971: 184-185).

Separation of authority at the Board level is important. Boards with high accountability include a strong base of independent outside directors, looking after the interests of all shareholders – both majority and minority holders. Conversely, companies with a strong majority shareholder may have Boards with limited accountability to shareholders.

A Board should be structured in such a way as to ensure that the interests of all the shareholders may be represented fairly and objectively. It should also bear overall accountability for the performance of the company. The separation of ownership and control under diffused ownership presents managers with opportunities to squander shareholders' wealth (Berle and Means 1932; Jensen and Meckling 1976: Shleifer and Vishny 1997). As a result, academics and practitioners emphasize incentive alignments through high managerial ownership and effective monitoring by the Board of directors (Crystal 1991; Jensen 1993; Byrne 1996). According to these authors, convergence of interest and improved monitoring promote corporate performance and shareholder values.

Adams and Ferreira (2003) analysed the consequences of the Board's dual role as an advisor and a monitor of management. Because of this dual role, the manager faces a trade-off concerning the amount of information he discloses to the Board. On the one hand, if he reveals his information, he gets better advice. On the other hand, the Board may change its opinion of his ability on the basis of his information. The authors' model showed that the Board may choose to pre-commit to reduce its monitoring of the manager in order to encourage the manager to share his information. Therefore, management-friendly Boards may be optimal governance structures under certain circumstances. The authors discussed some evidence consistent with the new empirical implications of their theory.

Therefore, as regards the second element of corporate governance – board of directors – the null hypothesis is as follows.

H_0 (2): Differences observed in the mean scales of the four categories of participants (board of directors' members, chief executive officers, audit committee members and shareholders) – with respect to the board of directors – are statistically insignificant in Saudi joint stock corporations.

This hypothesis is statistically formulated as follows.

$H_{0\,BD}$: $\mu_{board} = \mu_{ceo} = \mu_{audit} = \mu_{share}$ $H_{1\,BD}$: $\mu_{board} \neq \mu_{ceo} \neq \mu_{audit} \neq \mu_{share}$

Note		
	μ_{board}	Mean of sample1 (board of directors)
	μ_{ceo}	Mean of sample2 (chief executive officers, CEO)
	μ_{audit}	Mean of sample3 (audit committee members)
	μ_{share}	Mean of sample4 (shareholders)
	$H_{0\,BD}$	Null hypothesis in respect to board of directors
	$H_{1\,BD}$	Alternative hypothesis in respect to board of directors

5.4.3. Audit Committees, Internal Audit and Agency Theory

It is argued that Boards of directors, as well as audit committees, should be structured to be independent of management to be able to perform their independent oversight functions.

Since the audit committee's primary function is to oversee the financial reporting process of the firm, much emphasis has been put on the audit committee's role in preventing fraudulent accounting statements. Antle and Nalebuff (1991), Dye (1991) and Magee and Tseng (1990) argued that legitimate differences of opinion might exist between management and outside auditors in how best to apply GAAP. Antle and Nalebuff (1991) concluded that these differences would result either in the auditor being dismissed or, more likely, in a negotiated final financial report. DeFond and Subramanyan (1998) argued that client litigation risk might result in auditors preferring more conservative accounting choices than management for clients they perceive to be more risky. DeFond and Subramanyan (1998) found evidence consistent with this assertion for a sample of firms experiencing auditor changes.

Therefore, it could be concluded that the audit committee's role is to be a diligent arbiter (Beasley et al. 1999; BRC, 1999; Horton et al., 2000; Sommer, 1991) between Board of directors and management to reduce the agency problem. Audit committees are to weigh and broker divergent views of both parties to produce ultimately, a balanced, more accurate, report. Equivalently, its role is to reduce the magnitude of positive or negative discretionary accruals (Klein 2002). Audit committees could achieve this goal by meeting regularly with the firm's outside auditors and internal financial managers to review the corporation's financial statements, audit processes and internal accounting controls. Menon and Williams (1994) argued that to be effective monitors it is not enough that audit committees be independent – they must also be active.

More importantly, the audit committee must be independent to achieve its expected roles. Both Raghunandan et al. (2001) and Scarborough et al. (1998) reported survey results indicating that audit committees composed only of independent directors were more likely to have stronger relationships with internal auditors than were audit committees with one or more insiders. The Treadway Commission (1987) recommended that the Boards of directors of all public companies be required to establish audit committees composed solely of independent directors. The Blue Ribbon Committee on Improving the Effectiveness of Corporate Audit Committees (1999) recommended that companies have audit committees composed entirely of independent outside directors.

Studies have highlighted the link between audit committee member independence and fraudulent financial reporting. Abbott et al. (2000) and Beasley et al. (2000) found that companies with audit committees composed of independent directors were less likely to be sanctioned by the SEC for fraudulent or misleading financial reporting. McMullen and Raghunandan (1996) found that companies with reporting problems were less likely to have audit committees composed solely of outside directors. Klein (2002) found that audit committee independence was negatively associated with abnormal accruals and that reductions in audit committee independence were associated with large increases in abnormal accruals.

Haka and Chalos (1990) surveyed audit committee chairs, management, external auditors and internal auditors about their perceptions of agency conflict. Their findings support the existence of agency conflict between audit committees and management in areas related to financial disclosure and discretionary accounting procedures. Audit committee chairs' opinions about issues affecting accounting choices also differed from opinions provided by external auditors and internal auditors. Cohen et al. (2002) interviewed practising auditors and found that auditors viewed corporate governance as centred around management, rather than the Board.

Therefore, as regards the third element of corporate governance – audit committees– the null hypothesis is as follows.

H_o (3): Differences observed in the mean scales of the four categories of participants (board of directors' members, chief executive officers, audit committee members and shareholders) – with respect to the audit committees – are statistically insignificant in Saudi joint stock corporations.

This hypothesis is statistically formulated as follows.

$H_{o\,AC}$: $\mu_{board} = \mu_{ceo} = \mu_{audit} = \mu_{share}$ $\quad$ $H_{1\,AC}$: $\mu_{board} \neq \mu_{ceo} \neq \mu_{audit} \neq \mu_{share}$

Note		
	μ_{board}	Mean of sample1 (board of directors)
	μ_{ceo}	Mean of sample2 (chief executive officers, CEO)
	μ_{audit}	Mean of sample3 (audit committee members)
	μ_{share}	Mean of sample4 (shareholders)
	$H_{o\,AC}$	Null hypothesis in respect to Audit Committees and Internal Audit
	$H_{1\,AC}$	Alternative hypothesis in respect to Audit Committees and Internal Audit

5.4.4. Disclosure, Transparency and Agency Theory

Effective disclosures and transparent practices force managers in control of a company to exercise more care and diligence and force them to manage the company better since they know that poor performance can and will be scrutinised. This encouragement of better management will reduce agency costs and translate into better corporate performance.

The author agrees that effective external disclosure reduces the information asymmetries in an organization (Botosan, 1997; Botosan and Frost, 1998; Welker, 1995; Sengupta, 1998; and Healy et al. 1999), which consequently alleviates agency problems, and allows markets to function more effectively. Moreover, Malone et al. (1993) argued that external disclosure could be cost efficiently substituted with the private monitoring by non-executive directors. Williamson (1975) argued that the primary reason for market failure in different parts of the world is asymmetric information in the market. Simon (1962) argued that asymmetric information generally arises from complexity and uncertainty as to future outcomes. Williamson (1975, 1996) added that complex economic systems might opt for governance either by the market or by hierarchy. Coase (1937, 1992) argued that markets cannot be fully relied on as effective mechanisms of governance due to the costs of conducting and monitoring the market transactions necessary to support production and exchange. Governance by hierarchy, which involves "the suppression of the price mechanism" (Coase, 1937, 1992), is both rationally and legally supported. The legal basis of hierarchy is to be found in the property rights vested in the owners of productive capital, which need to be protected by managers who act on the owners' behalf. The overall objective of hierarchical control is to ensure that those with property rights – i.e., owners – get the maximum possible return on their investment (Collier and Esteban, 1999).

Disclosure of directors' shareholdings can reduce the agency problems arising from separation between ownership and control (Warfield et al., 1995) and can counter the need for additional disclosures and monitoring. The percentage of shares held by directors shows the kind of interest they have in the company. Directors with substantial share ownership try to profit from insider trading and therefore may have incentives to disclose less (Gul et al., 2001). They may, however, be more risk averse as share ownership transfers additional risk to the directors. They perceive that the cost of additional disclosure outweighs its benefits.

Therefore, as regards the fourth element of corporate governance – disclosure and transparency – the null hypothesis is as follows.

H_0 (4): Differences observed in the mean scales of the four categories of participants (board of directors' members, chief executive officers, audit committee members and shareholders) – with respect to the disclosure and transparency – are statistically insignificant in Saudi joint stock corporations.

This hypothesis is statistically formulated as follows.

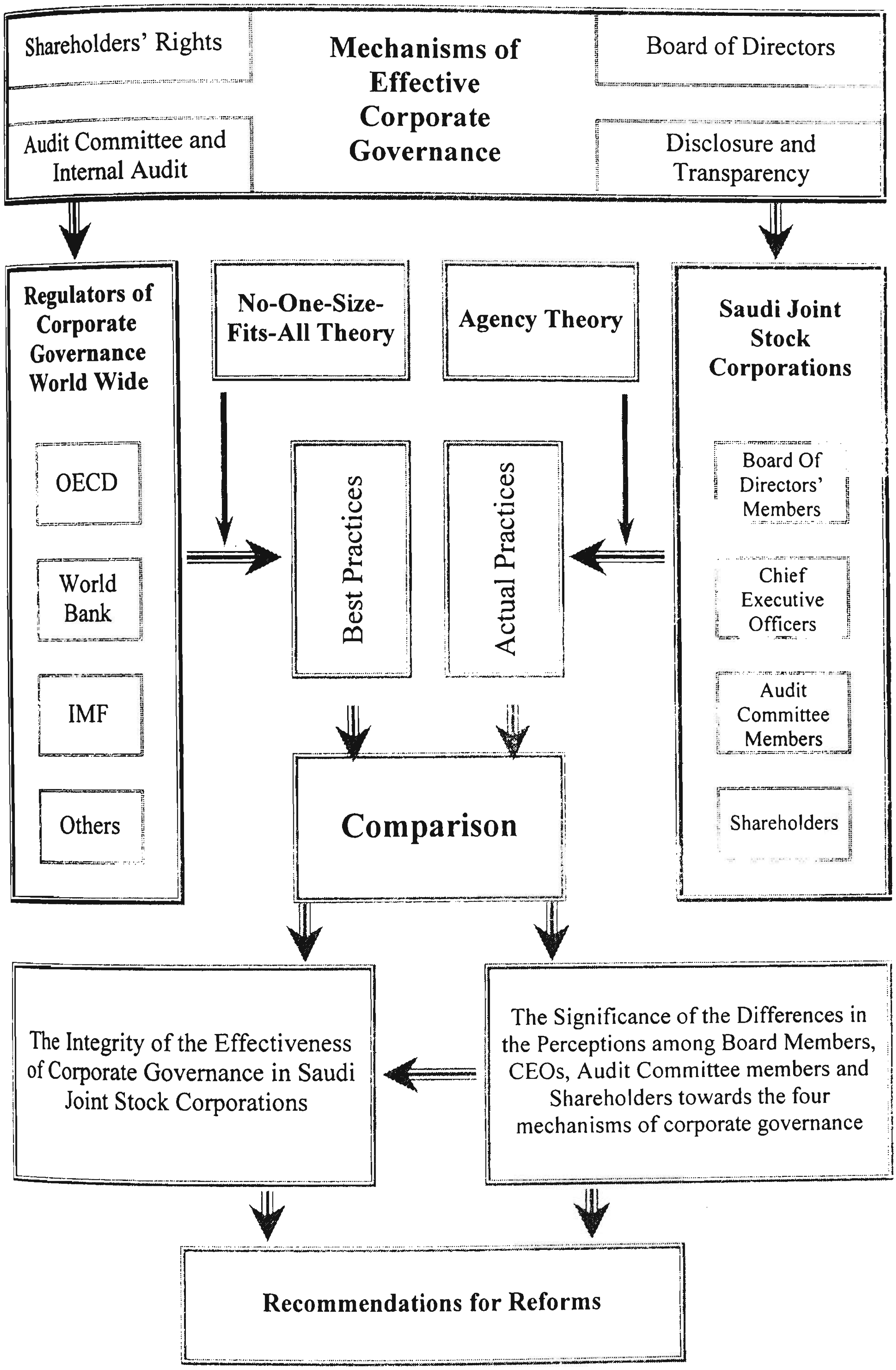
$H_{0\,D\&T}$: $\mu_{board} = \mu_{ceo} = \mu_{audit} = \mu_{share}$ $H_{1\,D\&T}$: $\mu_{board} \neq \mu_{ceo} \neq \mu_{audit} \neq \mu_{share}$

Note		
	μ_{board}	Mean of sample1 (board of directors)
	μ_{ceo}	Mean of sample2 (chief executive officers, CEO)
	μ_{audit}	Mean of sample3 (audit committee members)
	μ_{share}	Mean of sample4 (shareholders)
	$H_{0\,D\&T}$	Null hypothesis in respect to disclosure and transparency
	$H_{1\,D\&T}$	Alternative hypothesis in respect to disclosure and transparency

5.5. RESEARCH MODEL

In Figure 5.1, the interaction between the objectives, theory and hypotheses of this thesis are summarized.

Figure 5.1. Research Model



The board of directors' members, chief executive officers, audit committee members and shareholders of Saudi joint stock corporations are asked to evaluate the four mechanisms of corporate governance, namely: shareholders' rights; board of directors; audit committee and internal audit; and disclosure and transparency. The agency problem is likely to affect the participants' evaluation, as the agency problem increases in a company as the perceptions of the participants differ significantly. The agency theory is simply the existence of a conflict between the owners and management. If the agency problem is high in a company, trust would be low between management and owners which leads to a lower evaluation. . If, for instance, the owner of an 'A' company where the agency problem is high (conflict exist) is asked about his evaluation to a work that has been done by the management, his evaluation would probably be low. Therefore, it has been hypothesized that the differences observed in the mean scales of the participants (board of directors' members, chief executive officers, audit committee members and shareholders) with respect to the four mechanisms of corporate governance (shareholders' rights, board of directors, audit committee and internal audit, and disclosure and transparency) are statistically insignificant in Saudi joint stock corporations.

The evaluation is based on a comparison between the best practices of corporate governance, obtained from the guidelines and principles of corporate governance developed by related international organizations such as the World Bank, the International Monetary Fund (IMF) and the Organization for Economic Co-operation and Development Principles of Corporate Governance (OECD) with respect to the no-one-size-fits-all theory, and the actual practices of corporate governance in Saudi joint stock corporations.

The results of the comparison will guide the testing of the hypotheses of whether the differences in the perceptions of the four participating samples (board of directors' members, chief executive officers, audit committee members and shareholders) towards the effectiveness of the four mechanisms of corporate governance are significant or not. The comparison also gives clues to the integrity of the effectiveness of corporate governance in Saudi joint stock corporations as will be discussed in the result chapters.

5.6. SUMMARY

This chapter contains an overview of the theories, hypotheses and the literature that have been generated in the field of corporate governance. In general, the main conclusion which appears to have been suggested is of two parts. First, what is optimal for one firm in a particular geographical part of the world at one point in time may not be optimal in another time and place. Second, agency conflicts are heterogeneous across different firms in different industries and, most likely, different cultures. The scope of each type of agency conflict will differ from one firm to another, as will the effectiveness of corporate governance mechanisms (e.g., shareholders' rights, board of directors, audit committee and internal audit and disclosure and transparency) in reducing them. What is required is a more detailed understanding of what makes these mechanisms important for some firms – cultures – and ineffective for others. The corporate governance mechanisms should not be viewed in isolation from each other.

CHAPTER SIX:

RESEARCH METHODOLOGY

6.1. INTRODUCTION

The research design is the plan and structure of investigation, conceived so as to obtain answers to research questions. The plan is the overall scheme or program of the research. It includes an outline of what the investigator will do, from writing the hypotheses to the final analysis of data (Nardi, 2003; Marsh, 1982; Kerlinger and Lee, 2000; Vogt, 1992). Research designs are developed to enable researchers to answer research questions as validly, objectively, accurately and economically as possible (Ticehurst and Veal, 1999). In this thesis, the research plans are specifically executed to bring empirical evidence to bear on the research problem. Research problems have been stated in the form of hypotheses. A questionnaire has been carefully worked out to yield dependable and valid answers to the research questions epitomized by the hypotheses.

Research studies are conducted for the purpose of obtaining data that are ordinarily not available from other sources regarding a specific area of knowledge. Obtaining empirical data can be done using many different techniques. The most common ones include interviews, observations, case studies and questionnaires. The method selected depends on the goals and objectives of the research, the sample of respondents involved, the time set for the completion of the study and monetary considerations (Al-Assaf, 1993). It should be always remembered that,

> The research process is not a clear-cut sequence of procedures following a neat pattern but a messy interaction between the conceptual and empirical world, deduction and induction occurring at the same time (Bechhofer, 1974, p.73).

A typical questionnaire consists of a limited number of questions with pre-defined answer categories, focused on the topic of interest. It can also consist of some open questions where the informants need to write in answers in their own words.

Questionnaires are usually distributed to a sample of the target population and the responses are collected and then summarized using statistical analysis. The validity of a questionnaire is dependent on the honesty of the respondent's answers, which may be biased if the questions are leading (O'Brien, 1997, Litwin, 1995).

6.1.1. Thesis Review

This thesis is concerned directly with the manner in which joint stock corporations are managed in Saudi Arabia. However, in formulating an analytical framework for addressing governance issues, the author prefers to draw a distinction between, on the one hand, elements of good governance and, on the other, the specific areas of action (e.g., private sector) in which they could be promoted or their existence enhanced. In line with this reasoning, and building upon the approach of the multilateral organizations, four basic elements of good governance have been identified.

- Shareholder Rights
- Board of Directors
- Audit Committee and Internal Audit
- Disclosure and Transparency

One main purpose of this project is to quantify and evaluate the relative quality and effectiveness of corporate governance practice for each of the joint stock companies listed on Saudi Stock Exchange, *Tadawul*, by comparing the actual practice with the best practice. It is also an objective to identify any differences in the perceptions between the four participating groups (board of directors' members, chief executive officers, audit committee members and shareholders) towards the mechanisms of corporate governance.

In the process of the construction of the methodology, the author has considered various factors that best reflect corporate governance standards in Saudi Arabia. The choice of the variables is based on the corporate governance mechanisms. The author believes that this thesis has worked out a set of governance measures that truthfully reflect Saudi listed companies' governance practice.

6.2. TYPES OF RESEARCH METHODOLOGIES

There are three common types of research methods, namely: descriptive, correlational and experimental, utilized in the process of scientific research.

6.2.1. Descriptive Research Method

The first type of research is descriptive research in which the researcher attempts to document what is actually occurring. Descriptive research involves observation and description of variables as they are distributed throughout a population (Crowl, 1993). Quality observation (i.e., measurement) is at the heart of descriptive research (Heppner et al., 1992). Generally, descriptive research designs may be classified as either qualitative or quantitative.

6.2.1.1. Qualitative Descriptive Design

Qualitative research designs depend on the written or spoken words and/or observable behaviours as data sources (Boland, 1992). A study based upon a qualitative process of inquiry has the goal of understanding a social or human problem from multiple perspectives. Qualitative research is conducted in a natural setting and involves a process of building a complex and holistic picture of the phenomenon of interest.

There are several types of qualitative research. Naturalistic-Ethnographic research involves observation and description of phenomena within a specific context (Wiersma, 1995). That is, research is conducted in a "natural setting" such as a classroom or a counselling centre; the principal data collected are usually field notes. The purpose of naturalistic-ethnographic research is to observe and document what occurs in the setting without manipulating variables or imposing structure. Although limited generalizability of results is an inherent weakness of naturalistic-ethnographic research, naturalistic-ethnographic researchers are not concerned with issues of generalizability, but rather focus on providing context for data and on observation and description of what occurs without pre-conceived hypotheses (Smith and Glass, 1987; Wiersma, 1995; Hussey and Hussey, 1997).

Phenomenological research is similar to naturalistic-ethnographic research, but focuses on gaining participants' understandings of their environments, involvements, and experiences. Thus, for example, phenomenological researchers in counselling typically collect data by interviewing group members and facilitators to try to make sense of how they experience the group process. "Bracketing" and "horizontalization" are important in order to minimize researcher bias. Bracketing is the deferment of the researcher's personal prejudices and biases so as not to impose structure in the interview. Horizontalization involves treating all data as if it were equally important, thus avoiding the tendency to overemphasize data consistent with the researcher's preconceived notions (Heppner et al., 1992).

6.2.1.2. Quantitative Descriptive Design

Quantitative descriptive design is an inquiry into an identified problem, based on testing a theory, measured with numbers, and analyzed using statistical techniques. The goal of quantitative methods is to determine whether the predictive generalizations of a theory hold true. Quantitative descriptive designs yield numeric or statistical descriptive data about how variables are distributed among members of a population (Crowl, 1993). Quantitative methods include survey, classification research, passive designs and ex-post facto designs.

One of the main advantages of a quantitative approach to data collection is the relative ease and speed with which the research can be conducted. In a descriptive study, the use of quantitative methods can give a spurious objectivity to information, which can lead to reductionist tendencies. This means that the richness of the data and its contextual implications may be lost, thus contributing to a narrower and less real interpretation of phenomena (Hussey and Hussey, 1997).

Qualitative data collection methods can be expensive and time consuming, although it can be argued that qualitative data in business research provides a more 'real' basis for analysis and interpretation. Moreover, a qualitative approach presents problems relating to rigour and subjectivity (Hussey and Hussey, 1997).

6.2.2. Correlational Research Method

The second type of study is referred to as correlational research. In this type of research, the research relates the level of one variable to a corresponding level of another variable in an attempt to discover any relationships between them. The purpose of this type is to predict the level of one variable by knowing the level of a second variable. The researcher has only moderate, if any, control over the variables in this type of research (Tuckman, 1988).

Therefore, correlational research methodology seeks to find relationships between variables. "Is there a relationship between the attitudes of students and their level of achievement?" is an example of a question this type of research might answer. Statistics used for this analysis are the Pearson r and the Spearman *rho*, depending on the type of data generated (Gay and Airasian, 2000).

A limitation of correlational designs is that causal relationships cannot be firmly established. However, causal relationships may be ruled out if a non-significant correlation between the variables is found. Another limitation is that "convenience" samples are often used, thus limiting the external validity of results (Heppner et al., 1992).

6.2.3. Experimental Research Method

The third type of research is referred to as the experimental research. In this type, the researcher manipulates the level of one variable and observes the corresponding change, if any, in the level of another variable. The purpose of this type of research is to determine if there is a causal relationship between the two variables.

Experimental studies are conducted to support or refute a hypothesis. These studies typically have a control and an experimental group with a manipulated and a responding variable. An example of a hypothesis one would test is, "Using manipulatives in science has no effect on achievement test scores". In this case, the statistic used for analysis would be the Student t-test (Gay and Airasian, 2000).

6.3. RESEARCH METHODOLOGY USED IN THIS THESIS

Survey methodology is currently the most common approach used in a variety of fields ranging from economics and political science to environmental studies, marketing research, voting behaviour and health, among others, to study empirically the characteristics and interrelations of sociological and psychological variables (Roberts, 1999; Marsh, 1982; Young, 1996). Its development and application in the twentieth century have profoundly influenced the social sciences (Kerlinger, 1986).

Survey research has as a basic goal the collection of information about variables or phenomena within a population through use of interviews or questionnaires (Heppner et al., 1992). Survey research may be longitudinal (i.e., data collection over time at specified intervals) or cross-sectional (i.e., data collection at one point in time from different samples representing a population).

The survey or opinion approaches are often designed to measure the values, beliefs, attitudes, knowledge and the behaviour of people. The great advantage of this method is that it allows us to measure the attitudes and behaviours of large populations (e.g., country, state or city) by questioning a relatively small number of people, who are chosen through statistical/probabilistic procedures. Surveys, indeed, provide an efficient and economical means of determining facts about the economy and about people's attitudes, expectations and behaviours.

Common limitations of survey research include failure to allocate sufficient time and resources, improper sampling, inadequate measurements, non-respondent bias (i.e., how non-respondents differ from respondents) and failure to consider the sources of non-response that may lead to over-generalization of results (Wiersma, 1995).

6.3.1. Types of Survey

Surveys can be divided into three broad categories: written questionnaire (mail survey), telephone survey and personal interview (Table 6-1). Because the written questionnaire enjoys the benefit of cost advantages, it is overwhelmingly the most popular mode of administration found in accounting research using survey methods.

6.3.1.1. Written Questionnaire (mail-out survey)

Mail-out questionnaires are relatively inexpensive. Therefore, cost is a great advantage of this type of survey.

This method is best when the researcher needs to reach a large number of people spread over a wide geographical area. Respondents enjoy the greatest degree of anonymity of all the survey types and there is no bias introduced by an interviewer. Because mailed surveys tend to have a lower response rate, the target population needs to have a moderate to high degree of interest in the topic under investigation. Only motivated people will return the form. More errors occur in the data because the researcher has no control over the response process, he/she also does not get the opportunity to prompt or probe, and the researcher cannot ensure that all the questions are answered properly if at all. The availability of accurate and complete lists of potential recipients and the delay of return using mail delivery, therefore, are important considerations.

6.3.1.2. Telephone Survey

Telephone interviewing is a convenient way to collect a lot of information quickly at a lower cost. Therefore, this method is efficient and recommended in situations that require speedy results. While the interviewer can still provide clarification and verify answers, respondents enjoy greater anonymity. New methods for generating unbiased samples, such as random digit dialling, have improved the reliability of telephone surveys. As well, interviewers can be easily supervised and monitored. The main limitation of this method is the fact that not every person in the population has a telephone, which confines the efficacy of this data collection method to specific types of research. Telephone interviews also have a lower response rate. Because the interviewer cannot verify the responses by observing the interview subject, there is the potential for collecting inaccurate data.

6.3.1.3. Face-to-Face Interview

The questionnaire is filled out through a personal interview conducted by a trained interviewer. Face-to-face interviews are the most powerful type of survey because of the depth and quality of data that can be collected. When it is necessary to gather detailed information using open-ended questions, this is the most appropriate method to use. The interviewer can explain, probe, and verify. Visual aids can also be used. Because this type of survey requires considerable planning, interviewer training and personnel time, it is more expensive than mail or telephone surveys. Possible sources of bias in face-to-face interviews include interviewer influence and inter-interviewer differences. For example, interviewer influence may occur when a question is asked in a leading way that suggests a particular response. When more than one interviewer is collecting the data, there may be differences in how questions are posed or interpreted.

Table 6-1 Types of Survey (Comparison)

Type of Survey	Face-to-face	Telephone	Mail
Cost	High	Medium	Low
Time	Medium	Fast	Slow
Response Rate	High	Medium-high	Low

6.3.2. Strengths and Weaknesses of Survey Research

The author has considered the strengths of the survey approach to take advantage of them and also considered the weaknesses to be careful about them (Table 6-2).

Table 6-2 Strengths and Weaknesses of Survey Method

Strengths	Weaknesses
Inexpensive	Demanding of time
Wide scope (a great deal of information)	Low response rate
Administered from remote location	Hard for participants to recall information
Large samples are feasible	Participants may not tell the truth about a controversial question
More accurate	
High reliability	Standardization forces developing general questions
Many questions can be asked	

6.4. ADMINISTERING THE SURVEY IN THIS THESIS

This section of the chapter is divided into six major sub-sections, in each of which a different major step in administering the methodology used in this thesis, which is survey, is discussed. In order to obtain accurate results, it was necessary to go through each step properly (see Payne, 1951; Bradburn, 1983; Bradburn et al., 1979; Converse et al., 1986; Oppenheim, 1966; Sheatsley, 1983; Sudman et al., 1974, 1983; Turner, 1984; Warwick, 1975; Rea, 1992; Litwin, 1995).

6.4.1. Step I: Selecting the Type of Survey

One of the most critical decisions in many social research investigations is the selection of the appropriate type of survey. However, the researcher has chosen the mail-out questionnaire survey method as the best method for this study relying on a very few simple rules that made this decision easier. The researcher has used this judgment to balance the advantages and disadvantages of different survey types. In the decision process, the researcher asked a number of questions that guided this decision. Those rules and processes are as follows (Trochim, 2002).

6.4.1.1. Population Issues

Population Issues	How they have been considered
Can the population be enumerated?	Yes, they can be enumerated.
Is the population literate?	They are expected to be literate.
Are there language issues?	All subjects are Arabic speakers.
Will the population cooperate?	They are cooperative.
What are the geographic restrictions?	Dispersed over a broad geographic area.

6.4.1.2. Sampling Issues

Sampling Issues	How they have been considered
Who are your respondents?	Board members (BM), CEO, audit committee members (ACM) and shareholders (SHR).
Will addresses and phone numbers be available?	Available at the Ministry of Commerce.
Can all members of populations be sampled?	All BMs, CEOs and ACMs random SHRs
Are response rates likely to be a problem?	Follow techniques have been used (reminder letters, etc.)

6.4.1.3. Question Issues

Question Issues	How they have been considered
What types of questions will be asked?	Statements
How complex will the questions be?	Simple and understandable
Will screening questions be needed?	No
Can question sequence be controlled?	Yes (Section 6.4.2.6)
Will lengthy questions be asked?	No
Will long response scales be used?	Likert Scale has been used (Section 6,4,2,4)

6.4.1.4. Content Issues

Content Issues	How they have been considered
Can the respondents be expected to know about the issue?	Respondents are expected to be aware of corporate governance
Will respondent need to consult records?	No

6.4.1.5. Bias Issues

The written questionnaire has been chosen because it avoids the potential bias introduced by the interviewer (face-to-face or telephone). The challenge faced by the interviewer is that, on one hand, they must engage the respondent in ways that maintain the respondent's interest while, on the other hand, remaining dispassionate, even disinterested, in the subject matter of the questionnaire and in the nature of the respondent's answers (Sections 6.4.4.4 and 6.4.3.5.6).

6.4.1.6. Administrative Issues

The author has also considered the feasibility (costs, facilities, time and personnel) of the survey method for this study. Cost is often a major determining factor in selecting survey type. The cost of the mail-out questionnaire is the lowest amongst the other types of survey (Table 6-1). All the facilities needed for conducting the mail survey were available. Time also plays an important role in the decision of which type of survey could be better. Some types of surveys take longer than others (Table 6-1). This study does not require immediate responses. The author has budgeted enough time for this study to send out mail survey, do follow-up reminders and get the responses back by mail. Finally, different types of surveys make different demands of personnel. Interviews, for example, require interviewers who are motivated and well trained. Mail survey, however, does not require personnel.

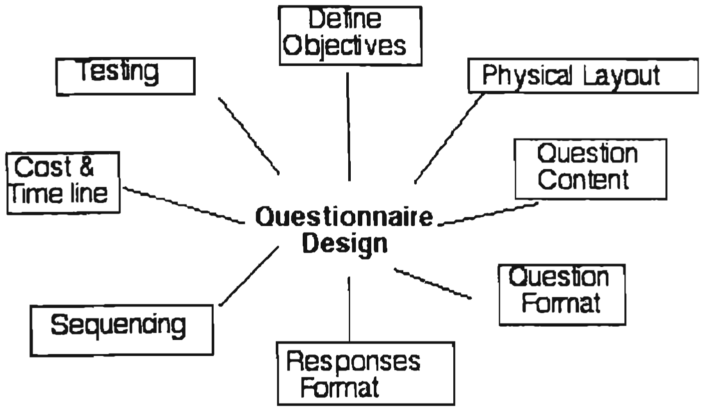
After consideration of these issues, it has been found that the mail-out questionnaire survey is the best to be used in the current study. The populations have been divided into two categories: the entire listed Saudi joint stock corporations, which are 71 firms, and 400 randomly selected shareholders (Section 6.4.4.3). The subjects have also been classified into four groups: board members, chief executive officers, audit committee members and shareholders.

6.4.2. Step II: Developing the Questionnaire

The structuring, wording, and ordering of questions have traditionally been viewed as "an art, not a science" (Payne, 1951: p. vii). Payne (1951: p. vii) cautioned that, "The reader will be disappointed if he expects to find a set of definite rules or explicit directions". "The art of asking questions is not likely ever to be reduced to some easy formulas" (Payne, 1951, p. xi). Thirty years later, Sudman et al. (1983) agreed that, "no 'codified' rules for question asking exist" (Sudman et al., 1983, p. 2). Experienced questionnaire designers have followed some conventions over the years, but those conventions varied from individual to individual and from discipline to discipline.

Because of the complexity in the questionnaire designing literature (Payne,1951; Bradburn, 1983; Bradburn et al., 1979; Converse et al., 1986; Oppenheim, 1966; Sheatsley, 1983; Sudman et al., 1974, 1983; Turner, 1984; Warwick, 1975; Rea, 1992; Litwin, 1995), it does not yield a short and efficient list of rules, each supported by a few documentary references, and each obviously justified by all relevant studies. But there is a great richness in the existing literature that provides useful guidance for scholars interested in maximizing the reliability, validity and efficiency of the measurement instruments they employ in their research. Carter et al. (1996) considered some guidance to questionnaire designs (Figure 6-1).

Figure 6-1:Development of Questionnaire Design (modelled after Carter et al., 1996)



6.4.2.1. Define Objectives

An effective questionnaire is concise and brief, one that does not bore the respondent with too many unnecessary questions. Questions need to address the objectives with no peripheral ideas (Frary, 1996). Oppenheim (2000) indicated that the main factor in questionnaire design is clarity, and that complex and confused wording must be avoided. Questionnaires without clear goals tend to be lengthy and waste the time of the respondents and the interpreters. Also, the researcher must ensure that the questionnaire is unambiguous, reliable and valid for the purpose for which it is to be used (Oppenheim, 2000).

The author in regards to the survey objective definition has considered and answered the following questions:

- What population do you want to survey? (board members, chief executive officers, audit committee members and shareholders).
- What information do you want the survey to collect? (Information in regards of the main purpose of this thesis, which is to quantify and evaluate the relative quality and effectiveness of corporate governance in Saudi Arabia).
- Will this be a mail survey, a telephone survey, a face-to-face survey? (It will be a mail survey).
- What is the time-line for completion of your survey? (Six months)
- How much money can you spend on it? (As needed)

6.4.2.2. Physical Layout

The author has considered the physical layout of the questionnaire. The questionnaire was laid out and printed in such a way that the respondent could follow all the instructions easily and answer all the questions. The questionnaire started with an invitation letter requesting the participants to support the researcher by responding the questionnaire. Then the letter introduced the purpose of the research project being undertaken. Clarity of layout and the overall impression given by the questionnaire were considered. The following factors have been carefully considered: length; appearance; instruction; and vertical flow.

6.4.2.2.1. Length: The researcher was aware that long questionnaires discourage the target respondents from completing the instrument and consequently it is either not fully completed or not returned at all. In both cases, the study's validity will be seriously jeopardized. Therefore, the questionnaire was considered to be as short and concise as possible. As the length of the questionnaire can affect the response rate in the postal survey, the author has used a typeset format. The questionnaire contains an invitation letter, a letter from King Saudi University emphasizing the confidentiality and five sets of questions, so the total pages was seven.

6.4.2.2.2. Appearance**:** A coloured cover page has been used to make the mailed questionnaire stand out from other papers on a busy person's desk. It was thought that the use of warm colours such as yellow or orange could achieve a higher response rate than cold colours such as blue or green. Dark colours that make the questionnaire hard read were avoided. An orange colour was used.

6.4.2.2.3. Instructions**:** The instructions in the questionnaire were clear, unambiguous and easily readable. The participants were given some general questions in the first section and asked to tick the appropriate box. In the rest of the questions (statements), the participants were also asked to tick the appropriate box for each statement. The statements were related to the effectiveness of their companies' corporate governance practices. Therefore, the instructions were as simple as ticking the appropriate box to each statement. All the questions were close-ended questions.

6.4.2.2.4. ***Vertical Flow*****:** Logical questions and section sequencing is critical. The author tried to avoid jumping from topic to topic by asking some general questions relating to the participants' category of respondents, group ages, industry, educations and experience. Then the questions were classified into four groups: shareholder rights, board of directors, audit committee and internal audit and transparency and disclosure.

6.4.2.3. Question Content

When considering the content of the questionnaire, obviously the most important consideration is whether the content of the questions will elicit the kinds of questions necessary to answer the research question. Rea and Parker (1997) noted six general problems to consider when preparing questions: (1) an inappropriate level of wording; (2) ambiguous words and phrases; (3) multi-purpose questions (i.e., questions that ask two or more opinions simultaneously); (4) manipulative information; (5) inappropriate emphasis; and (6) emotional words and phrases.

Oppenheim (2000) indicated that the main factor in questionnaire design is clarity, and that complex and confused wording must be avoided. Therefore, it is absolutely essential that a pilot study conducted to establish that the proposed questionnaire is intelligible and clear to members of the target population. Also, the researcher must ensure that the questionnaire is unambiguous, reliable and valid for the purpose for which it is to be used (Oppenheim, 2000; Easterby-Smith et al 2002).

The temptation to include questions without critically evaluating their contribution towards the achievement of the research objectives was avoided. No question was included unless it is directly related to the testing of one or more of the hypotheses established during the research design.

The words used in the questionnaire are simple, familiar and unambiguous to the target population and avoid colloquialisms or slang. Finally, and most importantly, the author tried to put himself in the respondents' shoes. He wrote a survey that he would be willing to answer himself, and he tried to be polite, courteous and sensitive when writing the questionnaire. At the beginning and the end of the questionnaire, the author thanked the respondents for participating.

6.4.2.4. Question Format

The importance of the way in which issues are framed in question wording has been recognized by survey researchers (Converse and Presser, 1986; and Schuman and Presser, 1981).

All questions in this instrument were constructed according to the Five-Point Likert Scale (see Schuman and Presser, 1996; Armit, 2003; Block et al., 2003; Cox 1980; Garland, 1991, 2003; Reardon, 2003) with a value of 1 indicating that the respondent strongly disagrees (not at all) with that factor or statement and the highest number, 5, indicating that the respondent strongly agrees (extremely) with that factor or statement in the actual practice in his corporation.

The use of the standardised questions in this study allowed the findings from a number of respondents to be summarised, and this was also facilitated by the use of questions, which are amenable to numerical analysis such as rating scales. The use of Likert rating scales in this study was found to be an effective way to enable consistent discrimination to be made between the differing groups of corporate governance, but some care was needed in their interpretation. Rating scales have proved especially useful in terms of issues such as ease and comfort of use and general acceptability. However; as with other measures of opinion, the technique does require that the respondents are reasonably articulate and able to voice or write their opinions. However some simple questionnaire techniques are likely to be of value even when used with people with limited communication skills, e.g., use of rating scales and rank order preferences of design alternatives.

Intensity questions were used to measure the strength of the respondent's feeling or attitude on the corporate governance practices in his company. The questions (statements) used in the questionnaire allowed the author to obtain more quantitative information about corporate governance in Saudi Arabia.

The Likert scale allows the respondent to choose one of five degrees of feeling about a statement from strong approval to strong disapproval. The questions were in the form of statements that seemed either definitely favourable or definitely unfavourable toward the matter under consideration. The answers were given scores (or weights) ranging from one to five, with the highest weight, 5, going to the answer showing the most favourable attitude toward the subject of the survey.

6.4.2.4.1. Advantages and Disadvantages of the Likert Scale

Advantages

- responses are gathered in a standardized way;
- relatively quick to collect information;
- relatively quick to collect information;
- can be relatively easy simple to construct;
- can be collected from a large portion of a group;
- easy to use; and
- gives participants a wide range of choses which may make them feel more comfortable.

Disadvantages

- participants may not be completely honest - which may be intentional or unintentional (to overcome this disadvantage, a check question technique was used, e.g., a question was asked twice in different places);
- may answer according to what they feel is expected of them as participants (respondents were asked to answer based on the actual practice not the best practice); and
- can take a long time to analyse the data (time is managed).

6.4.2.5. Responses Format

There are two different types of responses: open -ended and closed-ended format. The issue of open-ended versus close-ended formats has already been well researched in the case of survey questionnaires (see Dohrenwend, 1965; Schuman and Presser, 1979; Schuman and Scott, 1987; Schuman et al., 1986; Sudman and Bradburn, 1974; Carter and Williamson, 1996; Frary, 1996; and others).

6.4.2.5.1. Open-ended Format

In the open-ended format, the respondent is required to come up with an answer himself. This type of format is particularly likely to be used in an exploratory study, and can be used in order to identify the range of responses that should be used in multiple-choice questions. This format requires more effort both from the informants in order to write the answers, and from the analyst to interpret and systematise them. However, such open-ended questions can be a rich source of information, providing the respondents are motivated enough to fill in the questions fully.

Dillman (1978) claimed that open-ended questions are likely to be used in two distinctly different situations. One is a situation in which respondents can express themselves freely. The other common use is to elicit a precise piece of information that respondents can recall without difficulty when there are a very large number of possible answers and listing all of them would increase the difficulty of answering.

6.4.2.5.2. Closed-ended Format

Closed-ended questions limit respondents' answers to the survey. The participants are allowed to choose from either a pre-existing set of dichotomous answers, such as yes/no, true/false, or multiple choice with an option for "other" to be filled in, or ranking scale response options. The most common of the closed-ended format is the Likert scale questions, which will be used in this instrument. Closed format questions are easier to interpret and obtain statistical analysis from and are not complicated by any irrelevant responses that may occur with open format questions.

The author has used a closed-ended format in the questionnaire design to take advantages of the easiness of interpretation, recording, coding and analysing. This thesis uses a relatively large-scale survey, therefore, closed-ended questions are better because they take less time from the researcher and the participant, and this method is less expensive.

In a questionnaire survey, open questions may deter busy respondents from replying to the questionnaire. Closed-ended questions offer a series of alternative answers among which the respondent must choose, like a multiple-choice examination question (Weisberg et al, 1996). Closed questions are very convenient for collecting factual data and are usually easy to analyse, since the range of potential answers is limited. It is also easy and inexpensive to work with the resulting data. If the closed-ended format is chosen, however, care must be taken in writing the answer choices so that all possible opinions are included and none of the categories overlap

(Weisberg et al, 1996). Dillman (1978) also pointed out that questions of the closed-ended type are often used to establish priorities among issues and decide among alternative policies. Similarly, closed-ended questions are indispensable for exploratory studies in which the researcher's main purpose is to find the most salient aspects of a topic, perhaps in preparation for developing closed-ended questions for a later survey. However, unless the researcher's knowledge of the subject allows meaningful answer choices to be stated, useful results cannot be obtained. Perhaps the most frequent criticism is that the preferred options of all respondents are not stated (Hussey and Hussey, 1997).

The author has used the Five-Point Likert Scale and ordered the categories into a logical progression between lower level responses to higher level responses without combining any categories: e.g., 1) Never; 2) Slightly; 3) Moderately; 4) Significantly; and 5) Extremely. Respondents were given the opportunity to rate both positive and negative responses. If only presented with one format, respondents tend to mark every item the same. By varying the response formats, respondents tend to evaluate each item independently (Frary, 1996).

6.4.2.6. Sequencing

One of the most difficult tasks facing the survey designer involves the ordering or sequencing of questions. Which topics should be introduced early in the survey, and which later? If the researcher leaves his most important questions until the end, he may find that his respondents are too tired to give them the kind of attention the researcher would like. If the researcher introduces them too early, they may not yet be ready to address the topic, especially if it is a difficult or disturbing one. There are no easy answers to these problems, therefore, the author has used his judgment.

The sequencing of questions is very important to keep the respondents interested and focused. Just as in other aspects of life, first impressions are important in survey work. The first few questions one asks will determine the tone for the survey, and can help put a respondent at ease. With that in mind, the opening few questions in the present questionnaire were easy to answer. The author started with some simple descriptive questions. The author did not begin the survey with sensitive or threatening questions. Instead, the survey began with some simple and clear general (category of respondent, industry, age group, level of education, etc.) questions.

The instructions were clear and written in a different font. All the questions and the statements were numbered to facilitate analysis. It is more common to place the easy questions first to encourage confidence and trust in the respondent. The inclusion of some demographic questions about the respondents also helped to personalise the questionnaire. The topics were grouped together into five categories, namely: general questions, shareholder rights' questions, board of directors' questions, audit committee questions and disclosure and transparency questions, for logical sequencing. The chance of tiring or boring the respondents increases when more is asked (O'Brien, 1997), therefore, the simplicity and clarity were also considered.

6.4.2.7. Cost and Timeline

Developing a good questionnaire can take time and effort, and it is important to consider early in the design of a questionnaire how it will be analysed. In addition, personal interviews can be time consuming to arrange and conduct, and for this reason postal questionnaires are more common. Developing a questionnaire can be costly in terms of the time of the developer and the analyser. Closed-ended formats are more cheaply administered as they can be read and analysed by a computer. Open-ended formats, however, are more expensive to the researcher as they have to be individually read and analysed. Stating a time line on the questionnaire is an important aspect of the introduction, especially in this case where the questionnaire is distributed by mail. Therefore, the respondents were given a 21-day time line to respond. During that time, the author tried to follow up with the respondents by calling them to encourage them to respond or mailing them reminder.

6.4.2.8. Testing

Given the complexity of designing a questionnaire, it is impossible even for the experts to get it right the first time round. The draft questionnaire should be circulated to experts and consultants for comments and suggestions. It is important to allow more than one person to provide feedback on this first draft. Thereafter it is revised and, if necessary, tested again.

A proper pre–test involves actual users from the target population, and should be completed with interviews to identify possible misunderstandings or other problems with the questionnaire. The researcher should go through the questionnaire topic by topic and ask informants about their overall reactions, what difficulties they had, how the questions were interpreted, what relevant issues were not tapped by the questionnaire, and what the informants thoughts were when not being able to respond to a question. It is important that as much criticism as possible is identified at this stage, and the importance of such piloting cannot be overestimated. In many cases the possibility to obtain good data stands and falls with a good pre–test or piloting procedure. The procedures used in this study when piloting are discussed in details after in Section 6.4.3.4.

6.4.3. Step III: Writing the Questionnaire

After all the questionnaire developments discussed in the previous step were considered, the questionnaire was divided into four parts, namely: shareholder rights, board of directors, audit committee and internal audit and disclosure and transparency. Some short demographic (general) questions were included in order to provide sufficient motivation for the respondents to complete and to reduce the possibility of boredom which might induce the respondent to give up. Thus, it was designed to give an impression of answering short sections, rather than a long questionnaire. The questionnaire was also designed to ensure that respondents followed precise and specified instructions. The final version of the questionnaire consisted of four parts without the demographic questions containing 58 questions.

It should be noted that questions in the questionnaires have been adopted from the best practices provided by the related organization and sources (OECD, 1999; Blue Ribbon Committee, 1999; Cadbury Committee, 1992; CLSA, 2001; Braiotta et al., 1999; Collier, 1992; Kalbers, 1992a, 1992b; Rezaee and Farmer, 1994; Aguilera et al., 2000; Beasley et al., 2001; Bird, 2002; Scott et al., 1994; Shultz, 2000; Agrawal et al., 1996; Charkham et al., 1999; Wolnizer, 1995; DeZoort, 1997; Rosenstein et al., 1990; Ryan et al., 2003; Lee and Stone, 1997; and others).

6.4.3.1. The Corporate Governance Groups

6.4.3.1.1. Group I: Shareholder Rights

Group I consists of 15 statements (A1-A15), which focus on the rights of shareholders as an important element of corporate governance.

Table 6-3 Shareholders' Rights Questions

Statement No	Statements	Statement Code
	SHAREHOLDERS' RIGHTS:	**A**
1.	Shareholders have secure methods of ownership registration	A.1
2.	Shareholders are able to practice their rights	A.2
3.	Shareholders obtain timely and regular information on the corporation	A.3
4.	Shareholders understand their rights	A.4
5.	Shareholders care about attending general meetings	A.5
6.	Shareholders are furnished with sufficient and timely information concerning general meetings (date, location and agenda)	A.6
7.	Shareholders participate in the general meeting discussion and ask questions to the board members	A.7
8.	Shareholders vote in general meetings and place items on the agenda	A.8
9.	Shareholders share in the profits of the corporation	A.9
10.	Shareholders elect members of the board	A.10
11.	All shareholders of the same class are treated equally	A.11
12.	Within any class, all shareholders have the same voting rights	A.12
13.	Procedures for general meetings allow for equitable treatment of all shareholders	A.13
14.	Insider trading and abusive self-dealing are prohibited	A.14
15.	Generally, shareholders get their rights	A.15

6.4.3.1.2. Group II: Board of Directors

Group II consists of 19 statements (B1-B19), which focus on the effectiveness of boards of directors and outside directors and their roles in enhancing corporate governance in a particular company.

Table 6-4 Boards of Directors Questions

<table>
<tr><th>Statement No</th><th colspan="2">Statements</th><th>Statement Code</th></tr>
<tr><td></td><td colspan="2">BOARD OF DIRECTORS:</td><td>B</td></tr>
<tr><td>16.</td><td colspan="2">The board of directors monitors the management</td><td>B.1</td></tr>
<tr><td>17.</td><td colspan="2">The board members act on a fully informed basis, in good faith, with due diligence and care, and in the best interest of the company and the shareholders</td><td>B.2</td></tr>
<tr><td>18.</td><td colspan="2">The board treats all shareholders fairly and equally</td><td>B.3</td></tr>
<tr><td>19.</td><td colspan="2">There are at least three non-executive members in the board</td><td>B.4</td></tr>
<tr><td>20.</td><td colspan="2">The board ensures compliance with applicable law and take into account the interests of stakeholders</td><td>B.5</td></tr>
<tr><td>21.</td><td rowspan="4">The board members fulfil their expected key functions including</td><td>Reviewing and guiding corporate strategy</td><td>B.6</td></tr>
<tr><td>22.</td><td>Setting performance objectives</td><td>B.7</td></tr>
<tr><td>23.</td><td>Overseeing the process of disclosure and communications</td><td>B.8</td></tr>
<tr><td>24.</td><td>Ensuring the integrity of the corporation's accounting and financial reporting systems</td><td>B.9</td></tr>
<tr><td>25.</td><td colspan="2">Board members do not provide consultation to their company and are not affiliated with a company that is an adviser or consultant to the company or senior management</td><td>B.10</td></tr>
<tr><td>26.</td><td colspan="2">Board members are not affiliated with a significant customer or supplier</td><td>B.11</td></tr>
<tr><td>27.</td><td colspan="2">There is an independent board committee for remuneration</td><td>B.12</td></tr>
<tr><td>28.</td><td colspan="2">There is an independent board committee for nomination</td><td>B.13</td></tr>
<tr><td>29.</td><td colspan="2">There is an independent board committee for auditing</td><td>B.14</td></tr>
<tr><td>30.</td><td colspan="2">The roles of the chief executive officer and the chairman of the board of directors are separated</td><td>B.15</td></tr>
<tr><td>31.</td><td colspan="2">The board members devote sufficient time to their responsibilities and attend at least 75% of meetings, on average.</td><td>B.16</td></tr>
<tr><td>32.</td><td colspan="2">The firm holds four or more regular board meetings per year</td><td>B.17</td></tr>
<tr><td>33.</td><td colspan="2">The board members have access to accurate, relevant and timely information</td><td>B.18</td></tr>
<tr><td>34.</td><td colspan="2">Generally, the board of directors is effective</td><td>B.19</td></tr>
</table>

6.4.3.1.3. Group III: Audit Committee and Internal Audit

Group III consists of 15 statements (C1-C15), which focus on the effectiveness of the audit committee and the internal audit and their roles in enhancing corporate governance in a particular company.

Table 6-5 Audit Committee and Internal Audit Questions

Statement No	Statements	Statement Code
	AUDIT COMMITTEES AND INTERNAL AUDIT:	**C**
35.	Audit committee exists and is independent from management	C.1
36.	The audit committee monitor and review the effectiveness of the company's internal audit function	C.2
37.	The audit committee approves the appointment and replacement of the internal audit head and discusses with him related matters	C.3
38.	The audit committee makes recommendations to the board in relation to the appointment of the external auditor, his remuneration and terms of engagement	C.4
39.	The audit committee reviews and monitors the integrity of the financial statements of the company before they are approved by the board of directors and publicly disseminated to ensure their objectiveness, accuracy, and timeliness	C.5
40.	There are at least four members in the audit committee	C.6
41.	Audit committee includes someone with expertise in accounting and auditing	C.7
42.	The committee members understand the audit committee functions	C.8
43.	Audit committee meets at least four times a year	C.9
44.	Audit committee member attend at least 75% of meetings, on average	C.10
45.	Agenda and related material are provided to members ahead of meetings	C.11
46.	Report on audit committee's activities provided at annual shareholder meeting	C.12
47.	Audit committee has access to relevant information	C.13
48.	Objectives, responsibilities and authority of the audit committee are clearly defined in a written statement (charter)	C.14
49.	Generally, the audit committee is effective	C.15

6.4.3.1.4. *Group IV: Disclosure and Transparency*

Group IV consists of 15 statements (D1-D15), which focus on the effectiveness of the disclosure and the transparency and their roles in enhancing corporate governance in a particular company.

Table 6-6 Disclosure and Transparency Questions

Statement No	Statements	Statement Code
	DISCLOSURE AND TRANSPARENCY:	**D**
50.	Disclosure and transparency are of high priority in the company	D.1
51.	The company discloses the company's objectives and policies	D.2
52.	The company discloses the financial statements and information in the newspaper	D.3
53.	The company has a website in the Internet	D.4
54.	The company discloses the financial and operating results of the company in Arabic	D.5
55.	The company discloses the financial and operating results of the company in English	D.6
56.	The company discloses major share ownership and voting rights	D.7
57.	The company discloses members of the board and key executives	D.8
58.	The company discloses the remuneration of the board members	D.9
59.	The company discloses material foreseeable risk factors	D.10
60.	The company discloses material issues regarding employees and other stakeholders	D.11
61.	The company discloses governance structures	D.12
62.	The company's information is prepared, audited and disclosed in accordance with the standards of accounting, financial and non-financial disclosure accepted by the Saudi Government	D.13
63.	Channels for disseminating information provide for fair, timely and cost-efficient access to relevant information by users	D.14
64.	Generally, the firm's disclosure and transparency are effective	D.15

6.4.3.2. The Demographic (General) Questions

Researchers almost always include demographic questions in their questionnaires, including corporate governance surveys. This is not merely nosiness on their part as these questions serve two main purposes: the first is to see how closely the sample replicates the population, and the second is to allow analysis of sub-groups of those responding to the survey.

Therefore, demographic questions have been used in this questionnaire to break down the data when the survey was completed. The first demographic questions consisted of six questions which were focused on the respondents' characteristics. The first question was to know the category of the respondent (shareholder, board member, audit committee member or chief executive officer). The second question was to determine the industry of the respondents. The first and second questions were very helpful in breaking/dividing the questionnaires and in testing the sampling bias. For example, the first question (category of respondent) helped to divide the questionnaires into four groups (board members, CEOs, etc.). The third question asked about the age group of a participant. The next three questions (4,5 and 6) were related to the educational qualifications for the participant since the resolution of the Saudi Ministry of Commerce required that members should have a good command of financial and accounting practices and standards, preferably with appropriate qualifications in this field (Ministry of Commerce, 1994). The seventh question was to determine the experience of the participants. The final question was related to the quantity of shares the participants had at the time of filling out the questionnaire. The inclusion of demographic questions allowed the author to obtain useful cross-sections of the survey results from the respondent groups, namely: the shareholders, the board of director members, the audit committee members and the CEOs.

6.4.3.3. Translating the Questionnaire into Arabic

Before translating the questionnaire into the Arabic language, the researcher discussed its questions with Professor Robert Clift, an accounting professor from the Business and Law School at Victoria University, for their suitability to test the research hypotheses. The questionnaire was then translated, pilot tested, edited and coded for the purpose of computer processing in the later stage of analysis.

The purpose of the Arabic version of the questionnaire was to permit respondents with little or no knowledge of English to participate in the survey. This was a very important stage in this study since any mistakes in translation could change the meaning and context of the questionnaire. To ensure that the translation was correct, the two versions (Arabic and English) of the questionnaire were given to two persons who were fluent in both languages to review the translation and comment on any mistakes. The translation was then checked and reviewed by a specialist in Arabic language and a specialist in accounting. The purpose of the review was to correct any Arabic grammatical errors and any mistakes in usage of accounting or auditing terms. After minor corrections had been made, the questionnaire was ready for pilot testing.

6.4.3.4. The Pilot Test

Designing a perfect survey questionnaire is impossible (Alreck et al., 1995; Salant et al., 1994). However, researchers can still create effective surveys. Alreck and Settle (1995) noted that even well trained and highly experienced researchers find some changes that will improve the performance of the questionnaire by conducting a pilot study. And sometimes the pre-testing of the questionnaire will reveal very serious errors, oversights, or problems that would have spelled disaster if they had not been detected and corrected before going into the field or the mail. Salant and Dillman (1994) also argued that pre-testing a questionnaire is like test-driving so, "test-driving" a questionnaire is time-consuming but absolutely essential.

The pilot test was conducted to assure the clarity and effectiveness of the survey questions and to test the reliability and validity in order to revise the survey prior to final administration. To determine the effectiveness of the present survey questionnaire, the author pre-tested it before actually using it. The pilot test helped the author to determine the strengths and weaknesses of his survey concerning question format, sequence, wording, order, layout, validity, reliability and other matters.

The present questionnaire was pre-tested in two stages. In the first stage, the author administered it using personal interviews in order to get better feedback of problems such as ambiguous questions and misunderstanding. The interviews were made with six academics with an interest in accounting and corporate governance, three accounting professionals and four PhD accounting students, who went through the questionnaire topic by topic. Then, the author asked the informants about their overall reactions, what difficulties they had, how the questions were interpreted, what relevant issues were not tapped by the questionnaire and what the informants thoughts were when not being able to respond to a question. The author tried to identify as much criticism as possible in this stage.

In the second stage, the revised questionnaire was pre-tested in the same way as it would be administered. In other words, the pre-test involved the actual users from the target populations, namely: eight shareholders, three board members, six audit committee members and two CEOs from the Saudi corporations.

All of the pilot questionnaires had a covering letter explaining the nature and objectives of research. The reviewers were requested to note their observations and then make recommendations about the questionnaire and comment on the ways to develop it as well as making suggestions that could facilitate the analysis of data.

The researcher received many useful suggestions from all the parties who took part in the pilot study. Some of these corrections were about rephrasing the words in some of the statements while others were suggestions about dividing the statements in the questionnaire into appropriate groups to facilitate interpretation and analysis.

6.4.3.5. Response Rate

While some authors suggest that postal surveys should commonly yield response levels between 60% and 80% (e.g., Hoinville and Jowell, 1978), response rates between 10% and 30% are not uncommon (Boyd and Westfall, 1972; Luck, Wales and Taylor, 1970). Alreck and Settle (1995) suggested that mail questionnaires with a return rate of about 10% are often considered normal. In Saudi Arabia where this study was conducted, a response rate of 15% is considered normal (Al-Turki et al., 2000).

Researchers have explored a wide range of techniques in their attempts to maximize response rates and reduce the possible non-response bias of mail surveys (Heberlein and Baumgartner, 1978; Yu and Cooper, 1983; Dillman, 1978, 1991, 2000; Lam, Malaney and Oteri, 1990; Von Reisen, 1979; Etzel and Walker, 1974). These efforts to stimulate response rates are as follows.

6.4.3.5.1. Cover Letter

A cover letter is an important factor that can increase the response rate. Kanuk and Berenson (1975) and Linsky (1975) felt the cover letter was one of the few direct opportunities for influencing respondents and motivating them to reply (Linsky, 1975). They suggested the cover letter should be taken very seriously. Unfortunately, they provide no clear recommendations on how to proceed. Dillman (1991) argues the cover letter is very important in increasing response rates, but provides no data or recommendations on how to proceed. A cover letter, however, usually tells the target respondents about the purpose of the study, its importance and its sponsors. The cover letter also assures the respondents of the confidentiality of their answers and that the information provided will be used for research purposes only (Al-Assaf, 1993).

The present researcher has used a letter that fulfilled the above suggestions to accompany the questionnaire. The cover letter in this study was short and to the point. The cover letter included the following: the study title, identification of the study sponsors, statement of the purpose of the study, identification of why they should complete the questionnaire, encouragement for prompt response, mention of the inclusion of a postage-paid, pre-addressed return envelope, indication of the confidentiality of the information they provide, the name and phone number of a person they can call with questions, thanks for their cooperation, an offer of a summary of results and period for reply (Appendix I).

6.4.3.5.2. Including Return Postage

Other methods used by researchers to increase the response rates include enclosing self-addressed pre-paid envelopes. The inclusion of a return postage with each questionnaire in the present study has increased response rates significantly.

6.4.3.5.3. Sponsorship

If the study is sponsored by recognised organisations, respondents are more likely to be motivated to complete and return the instrument. This study was sponsored by King Saud University, which is the leading university in Saudi Arabia. The researcher was supplied with an official letter from the Department of Accounting at the Business School at King Saud University confirming its sponsorship of this study and encouraging the target organisations to participate and complete the accompanying questionnaire. The letter also emphasized the confidentiality of the information and data gathered.

6.4.3.5.4. Anonymity and Confidentiality

Participation means very little if respondents are concerned about who sees their answers and how they are used. Respondents are more likely to provide honest answers when they are assured up front that their anonymity is respected and the answers they provide are confidential and that the examining university will only be able to see aggregate data without personal identifiers. Victoria University requires data collectors to provide assurances of confidentiality, along with assurances that the survey is voluntary. In this study, all questionnaire responses were confidential and the participants were assured that their names would not be disclosed and the information they provided would be confidential in the cover letter. The researcher was also supplied with an official letter from the Department of Accounting at the Business School at King Saud University confirming the anonymity and the confidentiality of this study and encouraging the target organisations to participate and complete the accompanying questionnaire.

6.4.3.5.5. Follow-up Efforts

Research in mail, telephone, and face-to-face interviewing has universally found that the most powerful determinant of response rates is the number of attempts made to contact a sample unit (Dillman et al. 1978, 1991, 2000; Goyder 1985, 1987). The follow-up technique is one of those extra attempts to contact a sample unit and, therefore, an effective way to increase the response rate. It is used either to check if the respondents received the instrument or to remind them to complete and return it.

In recent years, researchers have greatly improved the response rate to data collection in mail surveys by applying a technique called the Total Design Method (TDM) (Dillman, 1978, 2000). Dillman (2000) noted the importance of using a telephone call reminder. Gary Hanson (personal communication, January 27, 2001) indicated that a key practice that has helped him obtain high response rates was sending a letter to each individual in the sample.

The author set up a plan for using some follow-up techniques, so reminder letters were sent to all companies in each industry with the lowest response rate after two weeks (or more) of the first mailing was sent. The reminder letters were general and encouraging those who have not responded yet at the time of receiving the letters to do so. A second follow-up letter with a new questionnaire and a return envelope were sent to the respondents at the end of the third week (or more) of the original mailing. A third follow-up letter including a questionnaire was sent registered by mail to all of the companies in each industry with low response rate by the end of week seven of the original mailing. Two studies provided considerable evidence of the benefit of using the third follow-up approach. In one, a re-mail improved response rates from 39.5% to 50.0% (Von, 1979), and the other showed an increase from 38.8% to 52.9% (Etzel et al., 1974). The author also carried out field visits and used telephone, fax and email communications to contact most of the sample organisations.

6.4.3.5.6. Non-Response Problems: If the goal of the sample is to represent the study population, then non-respondents pose a problem. Are those who returned their questionnaires different from those who did not? To eliminate the response problems in this study, the author has used two approaches. Those approaches worked effectively to assess whether responses from non-respondents would have been significantly different from the data collected. In other words, those approaches compared the association between (i) known characteristics of both respondents and non-respondents, and (ii) responses from early and late respondents.

6.4.3.5.6.1. Respondents compared to non-respondents: Tests for non-response bias, using firm characteristics of industry and category of respondent, were carried out. For example, the following questions have been considered: have you received responses only from some industries and have not received anything from other industries? Have you received a very high response rate from a particular category

(CEOs, etc.) and\or very low response rate from another category? Fortunately, no significant differences were found between the characteristics of respondent firms and the characteristics of non-respondent firms. It could be concluded, therefore, that based on industry and category of respondent, there was no difference between firms that responded and those that did not.

6.4.3.5.6.2. Degree of association between early and late responses

The likelihood of non-response bias was also assessed using late responses as a proxy for non-responses. The assessment was made based on differentiating the responses from each of the four different groups, which are shareholders, board members, CEOs and audit committee members. However, the author found that there was unlikely to be a systematic bias due to differences between those who responded and who were included in the analysis and those who did not.

6.4.4. Step IV: Selecting the Sample

All surveys are concerned with identifying the 'research population' which will provide all the information necessary for answering the original research question. Often it is impractical to involve all members of this population. Therefore, selecting who participates in the survey is the crucial issue. For better selection of the sample in this study, the author has gone through the following steps.

6.4.4.1. Defining the Population

The first step in the sample selection is to define the population. It is extremely important first to identify who should be included in the sample. Since the current study is about corporate governance in Saudi joint stock corporations, the populations are: all board of directors members, all chief executive officers, all audit committee members and 400 randomly selected shareholders (see Section 6.4.4.3).

6.4.4.2. The Sampling Frame

The sample frame identifies the units to be surveyed. The sample frame in the present study was all-inclusive, so that every unit in the study populations that have been surveyed was included. The frame for the sample excluded any units that were not part of the study population being surveyed.

6.4.4.3. Sample Size

Perhaps the most frequently asked question concerning sampling is, "What size sample do I need?" The answer to this question is influenced by a number of factors, including the purpose of the study, population size, the risk of selecting a "bad" sample and the allowable sampling error (Israel, 1992).

Table 6-7 Sample size for *+/- 3%, +/- 5%, +/- 7%,* **and +/- 10% Precision Levels Where Confidence Level is 95% and P = .5 (Yamane, 1967)**

Size of Population	Sample Size (n) for Precision (e) of:			
	±3%	±5%	±7%	±10%
500	*	222	145	83
600	*	240	152	86
700	*	255	158	88
800	*	267	163	89
900	*	277	166	90
1,000	*	286	169	91
2,000	714	333	185	95
3,000	811	353	191	97
4,000	870	364	194	98
5,000	909	370	196	98
6,000	938	375	197	98
7,000	959	378	198	99
8,000	976	381	199	99
9,000	989	383	200	99
10,000	1,000	385	200	99
15,000	1,034	390	201	99
20,000	1,053	392	204	100
25,000	1,064	394	204	100
50,000	1,087	397	204	100
100,000	1,099	398	204	100
>100,000	1,111	400	204	100

* = Assumption of normal population is poor (Yamane, 1967). The entire population should be sampled.

In this study, the entire population has been used as the sample for three of the groups. The entire population was taken for the board of director members, the audit committee members and the chief executive offices in each of the Saudi publicly traded companies, 71. Although cost considerations make this impossible for large populations, a census was attractive for the present study since the population is small. The use of the census method eliminated sampling errors and provided data on all the individuals in the population. Virtually the entire population would have to be sampled in small populations to achieve a desirable level of precision and generalizability.

The fourth group, which is shareholders, was too large, approximately 2.4 million shareholders. One way to determine the appropriate sample size for this group was to rely on the published tables which provide the sample size for a given set of criteria. Table 6-8 presents sample sizes that would be necessary for given combinations of precision, confidence levels, and variability. Based on the above criteria presented by Yamane (1967), which is shown in Table 6-7, and admitting that the author is adopting a precision level of 5%, the appropriate sample size for the shareholders was decided to be 400 individuals.

The information was taken from two sources, which are: the Saudi Arabian Market 'Tadawul' and the Saudi Commerce Ministry. The Tadawul provided the names of the listed companies in Saudi Arabia and the names of each individual in the population. The department of Administrating Companies in the Commerce Ministry provided the addresses of each of the subjects in the sample. The researcher ensured that he got positive answers to several questions in regards of the reliability of the information collected. Those questions were: how reliable is the address information that is provided? Is it updated on a regular basis? Does the source have a strong interest in making sure the address is correct? Will the address file include a specific individual's name (and perhaps title) or will it just be sent to a "company"? How will the addresses be provided: on labels? Or electronic version? Are there any limits on how the address information can be used?

6.4.4.4. Sampling Errors and Bias

Sampling errors occur when estimates are derived from a sample rather than a census of the population. This is the difference between the sample and the study population. The smaller the sample size relative to the population, the larger the sampling error, and the less representative the sample is of the study population. To avoid this error, the author has chosen to include the entire population for three groups, namely: all board members; all audit committee members; and all chief executive officers in all listed Saudi public companies. However, due to the huge number of shareholders, which is approximately 2.4 million, the author used a random sample and addressed this type of error.

To avoid bias in sampling shareholders, the author has used probability or random sampling techniques when selecting shareholders. The definition of random sampling is a sample drawn from a population in which every member of the entire target population has an equal chance of being included in the sample. The author has used 'systematic random sampling,' which is the best way to obtain an unbiased variance estimator, as suggested by (Murthy, 1967). The three other types of random sampling are simple random sampling, stratified sampling and multi-stage cluster sampling (Creswell, 2002). To conduct a systematic random sample, a list of the shareholders investing in the Saudi joint stock companies by the end of May 2004 was obtained from the Saudi Commerce Ministry. Then, the author has followed the following procedures:

- Number the shareholders from 1 to N, where N is the total number of population;
- Select at random a number between 1 and K where K is the next smallest integer less than N/n, where n is the sample needed;
- Denote the selected number by k, and
- Select the k-th unit, the K+k-th unit, and so on to the N (K-1)+k-th unit. In this way the author has selected n shareholder, each shareholder is a K unit separated on the list.

The list obtained from the Commerce Ministry indicated that there are an approximate number of N = 2,400,000 shareholders in Saudi Arabia. The researcher wishes to carry out a questionnaire survey of n = 400 shareholders. The ratio, N/n, = 2,400,000/400 = 6000, so k = 6000. Hence, every six thousand shareholder on the list will be given a questionnaire. First, a random number between 1 and 6000 was generated, 3000, and this became the starting point. The author then selected the following shareholders from the list: 3000, 3000+6000=9000, 15000, 21000, 27000, etc. If the same person was chosen twice, the next number would be taken. For example, if shareholder number 5, which is number 27000 in the list, is the same name as number 1, 3000, then this name would be ignored and the next number would be taken. That means that number 27001 would be taken instead of 27000 for the shareholder number 5, and then the selection would continue as 27001 + 6000 = 33001, 39001, etc. The same technique has been used if the shareholder selected was an institute or firm.

6.4.5. Step V: Measurement Checks

Measurement is one of the key building blocks for research. Conducting a questionnaire survey is the process of translating concepts into measurable variables. Validity and reliability are the two major issues that a researcher must take into consideration when he or she uses a data gathering or measurement instrument. The importance of validity and reliability has been well documented within the research methodology literature.

6.4.5.1. Validity

In ordinary language dictionaries "validity" refers to the truth and correctness of a statement. In the research methodology literature, there are narrow and broad definitions of validity. The narrow definition, validity is epitomized by the question: "Are we measuring what we think we are measuring?" (Kerlinger, 1973: pp. 457; Kerlinger et al., 2000: pp. 666). The assessment of a measurement instrument's validity, in this sense, corresponds to an evaluation of the accuracy and adequacy of the measurement instrument as an operational definition for the particular construct (DeVellis, 1991). Validity, however, "cannot be assessed directly" (Singleton et al., 1993: pp.121) and can only be "inferred from the manner in which (a measurement instrument) was constructed, its ability to predict specific events or its relationships to measures of other constructs" (DeVellis, 1991: pp. 43). In a broader concept, validity pertains to whether a method investigates what it is intended to investigate, to "the extent to which our observations indeed reflect the phenomena or variables of interest to us" (Pervin, 1984: pp. 48).

Validity is one of the most important concepts in survey research. According to the American Psychological Association, validity "...refers to the appropriateness, meaningfulness, and usefulness of the specific inferences made from test scores." (Standards for Psychological and Educational Testing, 1985, p. 9). In other words, if your findings need to be appropriate, meaningful and useful, they need to be valid.

Validity determines whether the research truly measures that which it was intended to measure or how truthful the research results are. In other words, does the research instrument allow the researcher to hit "the bull's eye" of his research object? The present author has determined validity by asking a series of questions. Starting with the research question itself, the author asked himself whether he could actually answer the question he has posed with the research instrument selected? To answer this question, the author checked different types of validity: content, criterion-related and construct. Have you pre-tested the instrument? For this question, the author first asked a number of people who know little about the subject matter whether the questions are clearly worded and easily understood. He also looked to other research and determined what it has found with respect to question wording or which elements needed to be included in order to provide an answer to the specific aspect of his research. Then the questionnaire was also pre-tested by a number of academics and professionals in accounting.

6.4.5.1.1. External Validity

External validity refers to the extent to which the results of a study are generalizable (Campbell and Stanley, 1966). A desire to have high external validity is one of the main arguments advanced for doing survey research in accounting. In order to generalize from the four samples drawn from the populations, the author involved the entire population for three samples out of four, which are the board of directors' members, the audit committee members and the CEOs for each of the entire listed companies in the Saudi Stock Exchange 'Tadawul'. In the selection of the fourth group, shareholders, the author was very careful to select a random sample of shareholders from all the listed Saudi public traded companies. The author, as it was detailed in the sample selection, has used a systematic random sampling and made sure that every shareholder had a chance to be selected. He also ensured that the sample was representative in terms of a reasonable sample size. Accordingly, a high degree of confidence can be placed on generalising the findings to other companies in Saudi Arabia.

6.4.5.1.2. Internal Validity

The most important classification of types of internal validity is that prepared by a joint committee of the American Psychological Association, the American Educational Research Association and the National Council on Measurements used in Education, which are: content, criterion-related and construct (Kerlinger, 1973; Kerlinger et al, 2000; Churchill et al, 2002).

The content validity of the instrument of this study was established through the pilot study as discussed earlier. During this period, the questionnaire was distributed to six academicians who had an accounting knowledge, three professionals in accounting, four PhD accounting students, eight shareholders, three board members, six audit committee members and two CEOs from the Saudi corporations. The results showed that the questionnaire covered the important aspects identified within the literature review. The results also showed that minor modifications were needed before the questionnaire could be finally used in the main study.

The criterion-related validity reflects the success of the measure used for some empirical estimating purpose. Researchers may want to predict some outcome or estimate the existence of some current behaviour or condition. The criteria used may be subjective (does the evidence agree with what a researcher believes) as well as objective (does the evidence agree with other findings of the researcher) (Churchill and Iacobucci, 2002).

The construct validity deals with the degree to which the scale represents the concept being measured (Tull and Hawkins, 1993). Attitude scales and personality tests generally concern concepts that fall into this category. Even though, this validation situation is much more difficult, researchers still want assurance that their measurement has an acceptable degree of validity.

The questionnaire used in this study contained clear and direct questions; this was reflected from the pre-tests, which showed that the construct validity is acceptable. Moreover, using the Likert scale with its 5 categories also contributed to improving the construct validity.

6.4.5.2. Reliability

Reliability is concerned with the accuracy and precision of a measurement procedure (Sekaran, 1992). Conceptually, reliability is defined as "the degree to which measures are free from error and therefore yield consistent results" (Peter, 1979: pp.6). It is distinguished from validity in that validity is represented in the agreement between two attempts to measure the same trait through 'different' methods, whereas reliability is the agreement between two efforts to measure the same trait through 'similar' methods (Churchill and Iacobucci, 2002). Oppenheim (2000: 159) described reliability as "consistency."

One method to test the reliability of the instrument that has been used in the current thesis is to use a similar question in more than one part in the questionnaire. This is called 'items internal-consistency reliability test.' It means that multiple items, designed to measure the same construct, will interrelate with one another (Spector, 1994). This procedure showed how the individual items of that specific scale compete to be incorporated in it whilst maintaining an acceptable level of reliability.

Another method used here to assess the internal homogeneity of a set of items was to look at all the items simultaneously, using coefficient alpha (Churchill and Iacobucci, 2002). One reason of using this method was that coefficient alpha has a direct relationship to the most accepted and conceptually appealing measurement model, the *domain-sampling model*, which was advocated by Cronbach et al. (1972).

This model holds that the purpose of any particular measurement is to estimate the score that would be obtained if all the items in the domain (population) were used.

This would be the errorless true score over the entire domain that a respondent would have. Since this was not possible, the use of coefficient alpha was by far the most appropriate method of assessment. Coefficient alpha provided a summary measure of the inter-correlations that existed among the items in the scale.

> "Coefficient alpha routinely should be calculated to assess the quality of measure. It is pregnant with meaning because the square root of coefficient alpha is the estimated correlation of the k-item test with errorless true scores" (Churchill, 1991 p. 498).

Coefficient alpha was developed by Cronbach (1951) as a generalized measure of the internal consistency of a multi-item scale (Peterson, 1994). The Cronbach's (1951) coefficient alpha was formulated as:

$$\alpha = \frac{k}{k-1}\left[1 - \frac{\sum SDi^2}{SDt^2}\right]$$

Where		
	α	Cronbach's alpha
	k	the number of items on the test
	Sdi	the standard deviation of an item
	SDt	the standard deviation of the test

The key assumption in the domain-sampling model is that all items, if they belong to the domain of the concept, have an equal amount of common core. This statement implies that the average correlation in each column of the hypothetical matrix is the same, and in turn equals the average correlation in the whole matrix. That is, if all the items in a measure are drawn from the domain of a single construct, responses to those items should be highly inter-correlated. Low inter-item correlations, in contrast, indicate that some items are not drawn from the appropriate domain and are producing error and unreliability.

Coefficient alpha provides a summary measure of the inter-correlations that exist among a set of items. Coefficient alpha routinely should be calculated to assess the quality of measures. If alpha is low, this outcome suggests that some items do not share equally in the common core and should be eliminated (Churchill and Iacobucci, 2002).

The equivalence measure of reliability for this study has been done to focus on the internal consistence or internal homogeneity of the set of statements, which formed the statements in the questionnaire into groups as mentioned above.

Despite the importance of reliability, there is surprisingly little guideance in the literature as to what constitutes "acceptable or "sufficient" reliability for research purposes (Peterson, 1994). Easterby-Smith et al (2002) claimed that the reliability coefficient in the order of 0.6 is acceptable. Table 6-8, adopted from Peterson (1994), contains illustrative recommendations regarding minimally acceptable reliability.

Table 6-8 Minimum Reliability Level (Peterson, 1994)

Author	Situation	Recommended Level
	Prediction for individual	Above .75
Davis (1964, p.24)	Prediction for group of 25-50	.5
	Prediction for group over 50	Below .5
Kaplan and Saccuzzo (1982, p.106)	Basic research	.7 - .8
	Applied research	.95
Murphy and Davidshofer (1988, p.89)	Unacceptable level	Bellow .6
	Low Level	.7
	Moderate to high level	.8 - .9
	High level	.9
Nunnally (1967, p.226)	Preliminary research	.5 - .6
	Basic research	.8
	Applied research	.9 - .95
Nunnally (1978, pp. 245-246)	Preliminary research	.7
	Basic research	.8
	Applied research	.9 - .95

Table 6-9 The Reliability Analysis Scale (Alpha)

Groups	Coefficient Alpha Values			
	Board of Directors	Chief Executive Officers	Audit Committee Members	Shareholder
Shareholders' Rights (15 Items)	.8977	.8382	.8819	.8944
Board of Directors (19 Items)	.8260	.8479	.8743	.8764
Audit Committees and Internal Audit (15 Items)	.8974	.8468	.9046	.8833
Disclosure and Transparency (15 Items)	.9341	.8688	.9040	.9357

Table 6-9 summarises the reliability analysis scale (Alpha) and provide the reliability coefficient values for each of the four participating groups, namely: board of directors' members, chief executive officers, audit committee members and shareholders. The results shown in Table 6-10 indicate that the reliability coefficient values are accepted and seem to be high.

When the questionnaires were received, they were also checked for correct completion. This process of editing and checking was conducted to ensure maximum reliability and validity of the data gathered.

6.4.6. Step VI: Determining the Results

When the survey questionnaires were completed and returned, getting them ready for data analysis was the next step. Transferring information on a questionnaire to a computer program (such as SPSS) was accomplished by assigning a value to each response category of a question, which is known as coding. A number was assigned to each response. It was found much easier to enter a single digit number such as "5" than to type out "strongly agree" or "extremely," "1" for "not at all" or "strongly disagree," etc. The author has designed his questionnaire so that every response to closed-ended item was already numbered. Rather than ask respondents if they were: (a) strongly disagree, (b) disagree, etc., he wrote the item as: (1) strongly disagree, (2) disagree, etc. This step will be discussed in details in the next two chapters.

6.5. SUMMARY

This chapter has explained the research approach adopted in this thesis. The chapter started by reviewing the main aim of this project, which is to quantify and evaluate the relative quality and effectiveness of corporate governance practice for each of the public companies listed on the Saudi Stock Exchange. In the process of the construction of the methodology, the author considered various factors that best reflect corporate governance standards in Saudi Arabia. The choice of the variables is based on the corporate governance mechanisms discussed in the previous chapters. The author believes that this thesis has worked out a set of governance measures that truthfully reflect Saudi listed companies' governance practice.

The chapter then presented common types of research methodologies used in the literature and the advantages and disadvantages of those methodologies. Then, it was demonstrated that the survey method was the most appropriate methodology to be used in this study. Some characteristics, rules, ethics, strengths and weaknesses of survey research methodology were also discussed.

The chapter was divided into six major sub-sections, each of which discussed a different major step in administering the survey methodology used in this thesis. Those steps were selecting the appropriate type of survey, developing the questionnaire, writing the questionnaire, selecting the appropriate sample, measurement checks and determining the survey results. In order to obtain accurate results, it was necessary to go through each step properly. Through these steps, the author has explained how the pilot study was carried out to develop the questionnaire and how it was conducted and the benefits that had been gained from parties of piloting.

The next chapter presents in more details the descriptive data analysis of this study and the different techniques and tests that will be carried out to achieve its objectives.

CHAPTER SEVEN:

QUANTITATIVE DATA ANALYSIS I:

DESCRIPTIVE STATISTICS

7.1. INTRODUCTION

All research will involve some numerical data, or contain data that could usefully be quantified to help the investigator to answer his research question and meet his objectives.

Quantitative research is a distinctive research strategy (Bryman, 2004). Bryman (2004) described quantitative research as "entailing the collection of numerical data and as exhibiting a view of the relationship between theory and research as deductive". Quantitative data refer to all such data and can be a product of all three main types of research strategy discussed in the previous chapter. It can range from simple counts such as creating simple tables or diagrams which show the frequency of occurrence through establishing statistical relationships between variables to complex statistical modelling.

Statistics texts (Kohler and Ramanathan, 2002; Kerlinger and Lee, 2000; Collis and Hussey, 2003; Hussey and Hussey, 1997; Weiers, 2005) commonly draw a distinction between two main types of quantitative data analysis: exploratory data analysis (descriptive statistics) and confirmatory data analysis (inferential statistics).

The exploratory (descriptive) data analysis is concerned with summarizing and presenting the data in tables, charts and other diagrammatic forms that enable patterns and relationships to be discerned which are not apparent in the raw data (Tukey, 1977; Matre and Gilbreath, 1987; Collis and Hussey, 2003; Weiers, 2005). Examples are descriptive statistics (mean, median, mode, variance and standard deviation), plots and distributions. On the other hand, confirmatory data analysis goes beyond mere description of the data and arrives at inferences regarding the phenomena for which the sample data were obtained (Weiers, 2005). Examples involve some more complex analysis like t-tests, regression/correlation and ANOVA.

The analysis of a single variable is known as univariate data analysis, two variable is known as bivariate data analysis and more than two variables is known as multi-variate data analysis (Bryman, 2004; Bryman and Cramer, 2004; Collis and Hussey, 2003; Tabachnick and Fidell, 2001).

In this chapter, the ideas outlined in earlier chapters about corporate governance effectiveness are built upon and the issues that need to be considered at the planning and analysis stages of the research project are discussed. The analysis in this chapter will mainly be concentrated on the exploratory data analysis focusing on univariate and bivariate data analyses. The author will be looking at four main groups of techniques when considering the exploratory data analysis approach. These techniques are frequencies, cross-tabulation, measuring location (central tendency) and measuring dispersion (spread). The next chapter will be related to the hypotheses testing which could be referred to the second type of analysis, the confirmatory data analysis. Thus, analytical techniques that the author has found to be of most use are outlined:

- preparing data for analysis by computer (Section 7.2);
- exploring and presenting the data by frequency distributions (Section 7.3);
- examining relationships and trends in the data by cross-tabulation (Section 7.4);
- describing the frequency distributions by means of a single value by the central tendency (Section 7.5);
- measuring the shape of the data distribution by the spread (Section 7-6).

7.2. PREPARING DATA FOR ANALYSIS

7.2.1. Data Validation

Before undertaking any detailed analysis, responses have been vetted for consistency and completeness. It was thought to be important to have a policy for handling inconsistent and or incomplete questionnaires. The author found that most respondents answered all questions so he decided to reject incomplete questionnaires. Therefore, two questionnaires have been ignored because they were only partly completed. The characteristics of the two rejected questionnaires were totally ignored to ensure that no systematic bias was introduced and to enable the author to have the same sample sizes for each question analyzed.

7.2.2. Partitioning the Responses

In formulating an analytical framework for addressing corporate governance issues, the author preferred to draw a distinction between the four elements of good governance, namely, shareholder rights, board of directors, audit committee and disclosure and transparency, in which they could be promoted or their existence enhanced. Therefore, the author needed to partition the responses into more homogeneous sub-groups before analysis. The partitioning was done on the basis of the first question in the demographic section, which was about whether the participant is a shareholder, board member, audit committee member or a chief executive officer.

7.2.3. Data Coding

Once information has been collected, it must be transformed into data (in the context of quantitative research, this is likely to mean that it must be prepared so that it can be quantified).

The author converted nominal and ordinal scale data from category names to numerical scores prior to the data being input into electronic data files. This translation was not intended to permit ordinal scale data to be analyzed as if they were simple numerical values. Rather, it was done because many statistical packages cannot handle categories represented by character strings. Actually, codes were put into the questionnaire along with category names, so coding was done during questionnaire design rather than during data analysis.

The author had designed the questionnaire so that every response to closed-ended question was already numbered.

7.2.3.1. Demographic Data

The inclusion of some demographic questions about the respondents helped to personalise the questionnaire. The demographic questions have been used in this questionnaire to break down the data after the survey was completed.

The first demographic question related to the category of the respondent (shareholder, etc.). The second question was to determine the industry of respondents. The third question asked about the age group of a participant. The next three questions (4-5-6) were related to the educational qualifications of the participant. The seventh question was to determine the experience of the participants. The final question was to determine the quantity of shares that the participants hold.

In the process of coding, the author converted all the demographic questions to numerical data. The first, second and fifth questions were considered as categorical or nominal variables since order ranking is not important to distinguish the categories in those questions. On the other hand, the third, fourth, seventh and eighth questions were considered as ordinal variables since these categories can be rank-ordered and the distance between the categories is unequal. Finally, question number six was not a numerical variable since it was the only text variable in the questionnaire (which asks participants to state the major in their degrees).

7.2.3.2. Corporate Governance Data

All questions related to corporate governance in the questionnaire asked participants to respond on an ordinal, five-point Likert agreement, scale. The respondents were asked to specify the extent to which they agree with a particular statement. They were offered the choice of: strongly agree, agree, neither agree nor disagree, disagree or strongly disagree. When coding, the author followed the common practice to convert the ordinal scale to its numerical equivalent (e.g., 1 if strongly disagree, 2 if disagree, 3 if neither agree or disagree, 4 if agree and 5 if strongly agree) and to analyze the data as if they were simple numerical data.

7.2.4. Data Entry

Traditionally, data were analysed either by hand or using main-frame computers. The former method was extremely time consuming and prone to error. Fortunately, the by-hand or calculator and charting elements of quantitative analysis have been incorporated into relatively inexpensive personal computer-based analytical software. These range from spreadsheets such as Excel, Lotus 123 and SuperCalc to more advanced data management and statistical analysis software packages such as Minitab, SAS, SPSS for Windows (Babbie and Halley, 2003; Robson, 1993). Robson (1993: 310) argued that quantitative data analysis is:

> A field where it is not at all difficult to carry out an analysis which is simply wrong, or inappropriate for your purposes. And the negative side of readily available analytical software is that it becomes that much easier to generate elegantly presented rubbish.

The Statistical Package for the Social Sciences (SPSS), which is the most widely used system of computer programs for data analysis, has been used in the current research. It provides a system for organising and analyzing data and reporting results in the form of reports and graphs. SPSS can handle large amounts of data and provide a wide range of basic and advanced data analysis capabilities (Green et al., 2004; Bryman, 2004). The system version used in this research was Version 12.0 which was the standard package licensed to Victoria University of Technology at the time.

Data were entered into SPSS. Each column on the data sheet corresponded to a question (variable) on the questionnaire, and each row corresponded to a separate questionnaire. Afterwards, all data were reviewed by another person to check for entry errors. No data entry errors were found except for a few cells, which were found to be blank. The researcher transferred the code numbers from the original instruments and the data were then screened and printed for patterns of missing values and outliers. No serious cases of these conditions were found. It was therefore concluded that the data collected were valid for the statistical tests.

7.3. PRESENTING FREQUENCIES

A frequency is a numerical value which represents the total number of observations for a variable under study (Collis et al., 2003). The frequency distribution is a display method that allows the data to be summarised even more effectively (Weiers, 2005). In other words, a frequency distribution indicates how 'popular' the different values of the variable are among the units of analysis.

7.3.1. Category of Respondents

The samples used in this study were the actual four groups of interest, namely: the board members, audit committee members, the chief executive officers (CEOs) and the shareholders in all publicly traded companies listed in the Saudi Stock Exchange (Tadawul), 71 companies at the time. Since all questionnaire responses were confidential and the participants were assured of anonymity and that the information they provided would be confidential, there was no way to know how many companies participated and how many did not. However, it was possible to know how many board members, chief executive officers, audit committee members and shareholders participated in this study.

Table 7-1 summarizes the collected data in a condensed form that can be readily understood and easily interpreted. Out of 968 questionnaires sent out to the four participating groups, 236 questionnaires have been received, which gives a 24 per cent response rate in total.

Table 7-1 The Frequency Distribution of the Category of Respondents

Category of Respondent	Sampled	Responded	Response Rate
Board member (BM)	213	44	21 %
Chief executive officer (CEO)	71	15	21 %
Audit committee member (ACM)	284	54	19 %
Shareholder (SHH)	400	123	31 %
Overall	**968**	**236**	**24 %**

Response rates for mail questionnaires between 10% and 30% are not uncommon (Boyd and Westfall, 1972; Luck, Wales and Taylor, 1970). Alreck and

Settle (1995) suggested that mail questionnaires with a return rate of about 10% are often considered normal. In Saudi Arabia, where this study was conducted, a response rate of 15% is considered normal (Al-Turki et al., 2000).

7.3.2. Industry

The joint stock companies listed on the Saudi stock market as of July 2004 are categorized into the following sectors (Table 7-2).

Table 7-2 Saudi Stock Companies Sector Category

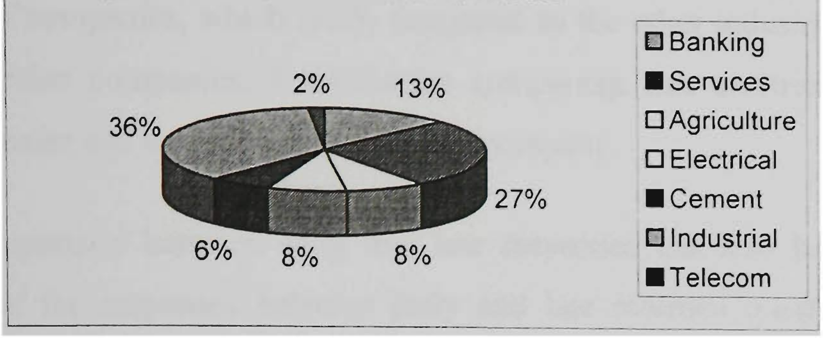
Sector (Industry)	Number of Companies	No./Total
Banking	9	12.7 %
Services	18	25.4 %
Agriculture	9	12.7 %
Electrical	1	1.4 %
Cement	8	11.3 %
Industrial	25	35.1 %
Telecom	1	1.4 %
Total	**71**	**100 %**

Table 7-3 The Frequency Distribution of the Industry

Industry	Absolute Frequency	Relative Frequency
Banking	30	12.7 %
Services	64	27.1 %
Agriculture	19	8.1 %
Electrical	19	8.1 %
Cement	14	5.9 %
Industrial	86	36.4 %
Telecom	4	1.7 %
Total	**236**	**100 %**

Table 7-3 summarizes the responses based on the industry. The highest percentage of the response rate was from the Industrial Sector (36.4%). That properly would be explained by the number of companies under that sector which was the highest, 25 companies, (Table 7-2). Only four responses were from the Telecom Sector because there was only one company listed under the telecom sector in Saudi Arabia (Table 7-2). Figure 7-1 shows the relative frequency distribution of the Industry Sector in a pie chart.

Figure 7-1 Responses Based on Sector



Tests for non-response bias, using firm characteristics of industry and category of respondent, were carried out. To eliminate the response problems in this study, the author has used two approaches. Those approaches worked effectively to assess whether responses from non-respondents would have been significantly different from the data collected. In other words, those approaches compared the association between (i) known characteristics of both respondents and non-respondents, and (ii) responses from early and late respondents. Fortunately, no significant differences were found between the characteristics of respondent firms and the characteristics of non-respondent firms. Also there were no significant differences between early and late responses.

Figure 7-2 indicates that there was no significant response bias amongst the four categories of responses. All the categories had almost the same response rate.

Figure 7-2 Responses Based on the Category of Respondent

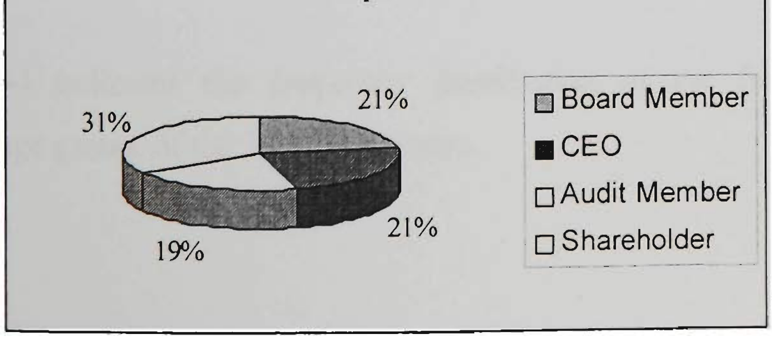


Figure 7-1 above confirmed that there was no significant non-response bias in the data collected. At the first glance at the chart, it could be seen that the Telecom Relative Frequency seems to be very low. However, the fact that there was only one Telecom Company in Saudi Arabia would make that percentage reasonable. Responses from the industrial sector seem to be high because this industry includes the number of companies, which is 25, compared to the other industries which are 9 banks, 18 service companies, 9 agriculture companies, one electrical company, 8 cement companies and one telecommunication company.

A comparison between early and late responses has also been made. The percentages of the responses between early and late returned questionnaires were almost the same for all different industries. Therefore, it was concluded that there was no significant bias in regards of this approach.

It could be concluded, therefore, that based on industry and category of respondent, there was no significant non-response bias and no early-to-late bias in the data collected and no difference between firms that responded and those that did not.

7.3.3. Respondents' Characteristics

The board head (e.g., chairman) should be responsible for periodically reviewing the appropriate skills, perspectives, experiences, age and characteristics required of board members, audit committee members and the chief executive officer (CEO) in the context of the perceived needs of their companies. The chairman of the board shall consider annually whether board members as well as the CEO can maintain their effectiveness in the company.

7.3.3.1. Age Group

Table 7-4 indicates the frequency distribution of the first respondents' characteristics, age group, of the 236 participants.

Table 7-4 The Frequency Distribution of the Age Group

Age Group	Absolute Frequency	Relative Frequency
25 years old or less	0	0 %
From 26 to 35	50	21.2 %
From 36 to 45	65	27.5 %
From 46 to 55	62	26.3 %
From 56 to 65	31	13.1 %
66 years old or over	28	11.9 %
Total	**236**	**100 %**

Table 7-4 shows that 28 people (12 %) of the participants were over 66 years. About half of the 28 was from the board members' category (see Table 7-10). The author does not believe that there should be term limits in the age group variable. While term limits could help ensure fresh ideas, they also would force the publicly traded companies in Saudi Arabia to lose the contributions of those participants who have developed an insight into the company. It is, however, believed that this insight and continuity of the participants, especially the board members and the CEOs, is an advantage to their companies. Proactive programs such as annual assessment and continuing education are preferred alternatives to arbitrary term limits.

7.3.3.2. Educational Qualification

The Saudi Ministry of Commerce requires board members, CEOs and audit committee members to have a basic level of financial literacy, preferably with appropriate qualifications in the relevant field (Ministry of Commerce, 1994). Table 7-5 indicates the frequency distribution of the highest level of education achieved by the participants.

Table 7-5 The Frequency Distribution of the Highest Education Level Achieved

Education Level	Absolute Frequency	Relative Frequency
Less Than High School	9	3.8 %
High School	2	.8 %
Bachelor	162	68.6 %
Master	38	16.1 %
Doctoral	7	3 %
Other (Board, Honour, etc.)	18	6.7 %
Total	**236**	**100 %**

It is believed that it is in the best interest of a company and its shareholders and stockholders to identify and select highly qualified candidates to serve as directors, CEOs and audit committee members. Board members, CEOs and auditors should have sufficient educational and professional qualifications to enable them to understand their entities' activities and denotation of information present in financial statements. Therefore, suitable educational and professional qualifications were considered necessary to be investigated in this study.

Only 9 (3.8%) participants had less than high school (3 board members and 6 shareholders) (see Table 7-11). These results reveal that there are at least 3 board members who did not have the minimum educational qualifications which seem to be important in fully understanding the procedures and process of financial reporting issues.

The majority of the participants (69%) had at least bachelor degrees, 16% had masters' degrees and 3% had PhD. The board members' and the CEOs' educational qualification is not only limited to the areas of accounting and auditing, however, it includes other areas with respect to having the basic level of financial literacy. Members of the audit committee, however, must have an accounting or related financial management expertise, requisite professional certification in accounting or any other comparable experience (SOCPA).

Table 7-6 The Frequency Distribution of the Country of Highest Education

Country	Absolute Frequency	Relative Frequency
Saudi Arabia	148	62.7 %
U.S.A	47	19.9 %
U.K	7	3 %
Australia	0	0 %
Other	34	14.4 %
Total	**236**	**100 %**

Higher education's tradition of exchanging ideas and people across borders has long served to advance its contribution to society's cultural, social and economic goals (Knight, 2002). Table 7-6 illustrates the country where the highest education level was achieved. The Table shows that the majority of the participants (63%) have had their highest education level from Saudi Arabia. The results show that the education trading between Saudi Arabia and Australia is 0%, between Saudi and the U.S. is 20%, between Saudi and the U.K. is 3% and between Saudi Arabia and other countries, mainly Egypt, is 14%. The importance of the higher education across borders takes place in the context of international development cooperation, academic exchanges and linkages, as well as commercial initiatives.

7.3.3.3. Participants' Field of Specialization

Table 7-7 The Frequency Distribution of the Field of Specialization

Field of Specialization	Absolute Frequency	Relative Frequency
Accounting	70	29.7 %
Arabic Language	4	1.7 %
Economics	2	3.3 %
Education	7	.4 %
Engineering	15	6.4 %
Islamic Law	2	.8 %
Law	12	5.1 %
Literature	2	.8 %
Business	37	15.7 %
Politics	6	2.5 %
Psychology	4	1.7 %
Religion	6	2.5 %
Sociology	18	7.6 %
N/A	51	21.6 %
Total	**236**	**100 %**

Table 7-7 shows that about 30 % of the participants specialized in accounting and about 16 % in business and 3.3 % in Economics which gives us a total of about 50% of the participants specialized in business related studies. More details will be illustrated in the cross-tabulation section (Table 7-12 and Table 7-17).

7.3.3.4. Participants' Experience

Table 7-8 indicates the frequency distribution of another important variable in the demographic questions which relates to the years of experience the participants had.

Table 7-8 The Frequency Distribution of the Experience of the Participants

Years of Experience	Absolute Frequency	Relative Frequency
5 Years or Less	36	15.3 %
From 6 to 10 Years	53	22.5 %
From 11 to 15 Years	19	8.1 %
From 16 to 20 Years	30	12.7 %
From 21 to 25 Years	26	11 %
26 Years or More	72	30.5 %
Total	**236**	**100 %**

As shown in Table 7-8, at least 72 participants (30%) had more than 26 years of experience in their job (18 board members, 6 CEOs, 14 audit members and 34 shareholders, Table 7-13) and half of that number, 36 participants (15%), had five years or less in their current job (4 board members, 2 CEOs, 10 audit members and 20 shareholders, Table 7-13).

Research on the issue of experience is inconclusive. Koontz (1967) and Juran et al. (1975) considered the bad effect of experience arguing that many corporate boards had too many older, less productive, board members. However, research conducted by Cohran, Warwick and Wood (1984) showed a positive correlation, albeit a very weak one, between younger boards of directors and financial performance. Vance (1983) argued that a positive correlation exists between financial performance and the average age of directors as a result of greater experience.

7.4. PRESENTING CROSS-TABULATIONS

In the above tables, the characteristics of the participants (board members, chief executive officers, audit committee members and shareholders) were analysed as univariate data. However, if a researcher wishes to analyse bivariate data; bivariate analysis is concerned with the analysis of two variables at a time in order to uncover whether the two variables are related, he/she may wish to construct a table which is known as a cross-tabulation or contingency table which shows how many people or items are in combinations of categories. In different words, the use of cross-tabulation enables the researcher to "generate a tabular display that describes how a selected quantitative variable tends to differ from one category to another or from one combination of categories to another" (Weiers, 2005: 54).

Although cross-tabulations can be constructed with any type of quantitative data, they are particularly useful for analysing nominal data (Hussey and Hussey, 1997). Cross-tabulation is one of the simplest and most frequently used ways of demonstrating the presence or absence of a relationship (Bryman and Cramer, 2004).

7.4.1. Category of Respondent * Industry Cross-tabulation

A cross-tabulation was used to examine the relationship between the participants' category of respondents and the industry. Table 7-9 presents the results of these analyses.

Table 7-9 Category of Respondent * Industry Cross-tabulation

Industry	Category of Respondent				Total
	B. Member	CEO	A.C.Member	Shareholder	
Banking	6	2	6	16	**30**
Services	14	3	20	27	**64**
Agriculture	-	3	4	12	**19**
Electrical	-	-	3	16	**19**
Cement	2	2	2	8	**14**
Industrial	22	5	19	40	**86**
Telecom	-	-	-	4	**4**
Total	**44**	**15**	**54**	**123**	**236**

The cross-tabulation shown in Table 7-9 illustrates how the combination of the two frequency tables (Table 7-1 and Table 7-3) are arranged such that each cell in Table 7-9 represents a unique combination of specific values of Table 7-1 and Table 7-3. By examining these frequencies, the researcher could identify the relations between the category of respondent and the industry.

Table 7-9 confirms that all the responses were generally reasonable and no significant response bias could be observed. However, a closer look at the Table shows that the board members responded only from four sectors as no responses were obtained from the board members in three sectors: agricultural, electrical and telecom. The non-responses from the telecom and the electrical sectors could be justified that there were only one company in each sector, however, in regards of the agricultural sector that seems to be a surprise.

The other observation from the cross-tabulation was about the Telecom company. It could be seen that no responses were obtained from that sector except for four shareholders. The lack of cooperation from that particular company could not be explained. The researcher tried to do some follow-up with them; however, no more responses could be obtained. The chief executive officers, the audit committee members and the shareholders have responded from all the seven sectors but the Telecom. Responses from the Industrial and the Service sectors would be related to the quantity of companies in those sectors. Therefore, it could be concluded that in general responses in respect to the category of respondent and the industry factors seem to be normal and no non-response bias could be observed.

7.4.2. Category of Respondent * Age Group Cross-tabulation

While term limits and a mandatory retirement age may help to ensure fresh ideas and viewpoints, they may also force companies to lose the contribution of directors and chief executive officers (CEOs) who, over time, have gained valuable insight into the business and operations of their companies. The researcher believes that experience as a board director or as a chief executive officer is a valuable asset, especially in light of the size and global scope of the Saudi corporation's operations. As an alternative to term limits, it is possible to insure that the board members and the CEOs continue to evolve and adopt new viewpoints.

Table 7-10 Category of Respondent * Age Group Cross-tabulation

Age Group	Category of Respondent				Total
	B. Member	CEO	A.C.Member	Shareholder	
≤25	-	-	-	-	-
26-35	6	-	18	26	**50**
36-45	10	4	16	35	**65**
46-55	8	8	12	34	**62**
56-65	10	1	4	16	**31**
66≥	10	2	4	12	**28**
Total	**44**	**15**	**54**	**123**	**236**

Table 7-10 shows that 177 (75%) participants aged from 26 to 55 years, 31 (13%) aged from 56 to 65 years and 28 (12%) aged 66 or over. A closer look at the 66 years or over participants gives a fact that half of that number were shareholders; which means that amongst the 113 (236-123) non-shareholding participants, there were only 16 (16/113=14%) aged 66 or over.

7.4.3. Category of Respondent * Qualification Cross-tabulation

Investors require information on individual board members, CEO and audit committee members in order to evaluate their experience and qualifications and assess any potential conflicts of interest that might affect their judgement (OECD, 2004).

The Saudi Ministry of Commerce requires that board members, CEOs and audit committee members have a basic level of qualification and financial literacy, preferably with appropriate qualifications in this field (Ministry of Commerce, 1994). Qualification is not only limited to the areas of accounting and auditing, however, it includes other areas with respect to having the basic level of financial literacy. Members of the audit committee, however, should have an accounting or related financial management expertise, requisite professional certification in accounting or any other comparable experience (Saudi Organization for Certified Public Accountants, SOCPA).

Table 7-11 Category of Respondent * Qualification Cross-tabulation

Qualification	Category of Respondent				Total
	B. Member	CEO	A.C.Member	Shareholder	
<High School	3	-	-	6	9
High School	-	-	-	2	2
Bachelor	23	10	44	85	**162**
Master	8	2	6	22	**38**
Doctoral	4	1	-	2	**7**
Other	6	2	4	6	**18**
Total	**44**	**15**	**54**	**123**	**236**

Table 7-11 indicates that at least 225 (95%) participants were educationally qualified or, in other words, had a bachelors' degree or more. That means that the participants with high school or less were only 11 (5%). Out of the 11 less-qualified participants, there were 3 board members and the rest were shareholders. In other words, it could be said that 7% (3/44) of board members had less than high school. It is sometimes said that being a director is the only professional job one can do without training, qualification or experience. However, it should be said that the shortage of trained, educated, competent and independent directors should be avoided.

7.4.4. Category of Respondent * Field of Specialization Cross-tabulation

Table 7-12 Category of Respondent * Field of Specialization Cross-tabulation

Specialization	Category of Respondent				Total
	B. Member	CEO	A.C.Member	Shareholder	
Accounting	6	4	26	34	**70**
Arabic Language	2	-	-	2	**4**
Economics	2	2	-	4	**8**
Education	-	-	-	1	**1**
Engineering	2	3	2	8	**15**
Islamic Law	-	-	2	-	**2**
Law	6	-	4	2	**12**
Literature	-	-	-	2	**2**
Business	12	3	4	18	**37**
Politics	-	-	-	6	**6**
Psychology	-	-	-	4	**4**
Religion	-	-	2	4	**6**
Sociology	-	-	2	16	**18**
N/A	14	3	12	22	**51**
Total	**44**	**15**	**54**	**123**	**236**

Table 7-12 shows that at least 20 board members (46%), 9 chief executive officers (60%) and 30 audit committee members (56%) specialized in business (accounting, business or economics) and the rest specialized in non-business fields. Although the board members and the CEOs should have sufficient educational and professional qualifications to enable them to understand their entities' activities and denotation of information present in financial statements, the audit committee members should have an accounting or related financial management expertise, requisite professional certification in accounting or any other comparable experience

(SOCPA). While 46% and 60% are very good percentages for the board members and the CEOs, the 48% (26/54) accounting specialized audit members might be considered low.

7.4.5. Category of Respondent * Experience Cross-tabulation

The Saudi Ministry of Commerce always emphasizes that individuals who are nominated to be a directors, CEOs or audit committee members should have demonstrated notable or significant qualification and/or achievements in business, should possess the requisite intelligence, education and experience to make a significant contribution to their companies and to the Saudi economy and should have the highest ethical standards, a strong sense of professionalism and intense dedication to serving the interests of the shareholders and the stockholders.

Table 7-13 Category of Respondent * Experience Cross-tabulation

Experience	Category of Respondent				Total
	B. Member	CEO	A.C.Member	Shareholder	
≤5	4	2	10	20	**36**
6-10	12	-	16	25	**53**
11-15	4	1	6	8	**19**
16-20	6	2	8	14	**30**
21-25	-	4	-	22	**26**
26≥	18	6	14	34	**72**
Total	**44**	**15**	**54**	**123**	**236**

Table 7-13 summarizes the experience of the four groups, namely: the board members, the chief executive officers, the audit committee members and the shareholders of joint public companies in Saudi Arabia, who participated in the current study. It is obvious that about 72 participants (31%) had 26 years or more experience in their current position. Article 66 of the Saudi Companies Law states that the board members must not be elected for more than three years at a time, however, the member could be re-elected (Ministry of Commerce, 1965). The board members who had 26 years experience or more were 18; 41per cent of all members sampled.

7.4.6. Category of Respondent * Share Ownership Cross-tabulation

The final question in the demographic part of the questionnaire was about the quantity of shares the participants hold. Table 7-14 illustrates the answers received.

Table 7-14 Category of Respondent * Share Ownership Cross-tabulation

Quantity	Category of Respondent				Total
	B. Member	CEO	A.C.Member	Shareholder	
No Shares	20	11	36	-	67
1-500	4	1	4	16	25
500-999	2	-	-	22	24
1,000-1,999	-	-	6	27	33
2,000-4,999	2	-	4	14	20
5,000-10,000	-	-	-	8	8
> 10,000	16	3	4	36	59
Total	**44**	**15**	**54**	**123**	**236**

Although Article 68 of the Saudi Companies Law stated that a director must hold shares in the company of not less than SR10,000 (US$2667) in value, 20 board members (45%) said that they did not hold any shares at the time. The Article stated that the shares must be deposited in one of the banks designated by the Minister of Commerce within 30 days of the director's appointment. The shares are to guarantee the responsibility of the board members and are non-transferable until the lapse of the time limit prescribed for the hearing of any liability suit against the director, or until a judgment is entered in a liability suit (Ministry of Commerce, 1965).

7.4.7. Educational Qualification * Experience Cross-tabulation

In addition to the qualification as an important factor in evaluating the effectiveness of corporate governance in Saudi joint stock companies, experience is another important factor that should be considered in the evaluation. Although the single variable frequency distribution analyses, which have been investigated above, has given a quick illustration to each of these factors independently, the cross-tabulation clarifies how the two variables or the two factors are related with respect to the category of respondents. The Tables 7-15 and 7-16 show these relationships.

Table 7-15 Qualification * Experience Cross-tabulation

Qualification	Experience						Total
	≤ 5	6-10	11-15	16-20	21-25	26 ≥	
< High School	-	3	-	-	-	6	9
High School	-	2	-	-	-	-	2
Bachelor	21	44	14	26	22	35	162
Master	15	4	-	-	4	15	38
Doctoral	-	-	3	4	-	-	7
Other	-	-	2	-	-	16	18
Total	**36**	**53**	**19**	**30**	**26**	**72**	**236**

Table 7-16 Category of Respondent * Qualification * Experience Cross-tabulation

Category of Respondent	Qualification	Experience						Total
		≤ 5	6-10	11-15	16-20	21-25	26 ≥	
Board Member	< High School	-	1	-	-	-	2	3
	High School	-	-	-	-	-	-	-
	Bachelor	2	9	-	4	-	8	23
	Master	2	2	-	-	-	4	8
	Doctoral	-	-	2	2	-	-	4
	Other	-	-	2	-	-	4	6
Total		**4**	**12**	**4**	**6**	**-**	**18**	**44**
CEO	< High School	-	-	-	-	-	-	-
	High School	-	-	-	-	-	-	-
	Bachelor	1	-	-	2	4	3	10
	Master	1	-	-	-	-	1	2
	Doctoral	-	-	1	-	-	-	1
	Other	-	-	-	-	-	2	2
Total		**2**	**-**	**1**	**2**	**4**	**6**	**15**
Audit Committee Member	< High School	-	-	-	-	-	-	-
	High School	-	-	-	-	-	-	-
	Bachelor	6	16	6	8	-	8	44
	Master	4	-	-	-	-	2	6
	Doctoral	-	-	-	-	-	-	-
	Other	-	-	-	-	-	4	4
Total		**10**	**16**	**6**	**8**	**-**	**14**	**54**
Shareholder	< High School	-	2	-	-	-	4	6
	High School	-	2	-	-	-	-	2
	Bachelor	12	19	8	12	18	16	85
	Master	8	2	-	-	4	8	22
	Doctoral	-	-	-	2	-	-	2
	Other	-	-	-	-	-	6	6
Total		**20**	**25**	**8**	**14**	**22**	**34**	**123**
Overall Total		**36**	**53**	**19**	**30**	**26**	**72**	**236**

In a survey developed by Robert Half International Inc. (a large staffing service specializing in the accounting, finance and information technology fields) which includes responses from 270 chief financial officers (CFOs) from a random sample of Canadian companies, the CEOs were asked, "If two candidates interviewing for an accounting or finance position had similar skills, which one of the following additional qualifications would you find most valuable?" Their responses: Industry-specific experience (55%), Software/technology knowledge (24%), Certification or advanced degree (13%), International experience (4%), Multilingual skills (3%) and Personality/people skills (1%) (Robert Half International Inc, 2004). Therefore, experience could tip the scale in shareholders' favour.

Obviously, the results in Table 7-15 and Table 7-16 show that amongst the three board members who had less than high school in their educational background, two members had more than 26 years experience and one had from 6 to 10 years of experience.

7.4.8. Educational Qualification * Field of Specialization Cross-tabulation

Table 7-17 Qualification * Field of Specialization Cross-tabulation

Specialization	Educational Qualification						Total
	< High School	High School	Bachelor	Master	Doctoral	Other	
Accounting	-	-	66	-	2	2	**70**
Arabic Language	-	-	4	-	-	-	**4**
Economics	-	-	7	1	-	-	**8**
Education	-	-	1	-	-	-	**1**
Engineering	-	-	15	-	-	-	**15**
Islamic Law	-	-	-	2	-	-	**2**
Law	-	-	12	-	-	-	**12**
Literature	-	-	2	-	-	-	**2**
Business	-	-	24	13	-	-	**37**
Politics	-	-	4	2	-	-	**6**
Psychology	-	-	-	4	-	-	**4**
Religion	-	-	6	-	-	-	**6**
Sociology	-	-	12	6	-	-	**18**
N/A	9	2	9	10	5	16	**51**
Total	**9**	**2**	**162**	**38**	**7**	**18**	**236**

Table 7-17 shows that 41% (66/162) of the participants with bachelor degrees had their bachelors in the accounting field and 60% (97/162) of them had their bachelor in the business area in general. 37% (14/38) of those participants with masters' degrees had their masters' degrees in business (no one in accounting) and 29% (2/7) of the participants with doctoral degrees had their doctoral degrees in accounting. The next Table (7-18) explains how the three variables (category of respondent, specialization and qualification) are interrelated.

Table 7-18 Category of Respondent *Qualification * Specialization Cross-tabulation

Category of Respondent	Specialization	Educational Qualification						Total
		< High School	High Schoo	Bachelor	Master	Doctoral	Other	
Board Member	Accounting	-	-	2	-	2	2	6
	Arabic Lang.	-	-	2	-	-	-	2
	Economics	-	-	2	-	-	-	2
	Engineering	-	-	2	-	-	-	2
	Law	-	-	6	-	-	-	6
	Business	-	-	6	6	-	-	12
	N/A	3	-	3	2	2	4	14
Total		3	-	23	8	4	6	44
CEO	Accounting	-	-	4	-	-	-	4
	Economics	-	-	1	1	-	-	2
	Engineering	-	-	3	-	-	-	3
	Business	-	-	2	1	-	-	3
	N/A	-	-	-	-	1	2	3
Total		-	-	10	2	1	2	15
Audit Committee Member	Accounting	-	-	26	-	-	-	26
	Engineering	-	-	2	-	-	-	2
	Islamic Law	-	-	-	2	-	-	2
	Law	-	-	4	-	-	-	4
	Business	-	-	4	-	-	-	4
	Religion	-	-	2	-	-	-	2
	Sociology	-	-	2	-	-	-	2
	N/A	-	-	4	4	-	4	12
Total		-	-	44	6	-	4	54
Overall Total		3	-	77	16	5	12	113

Table 7-18 shows that there are 48% (26/54) of the audit committee members specialized in accounting. In view of the significance of financial statements and the external auditor's report, the audit committee member overseeing such statements should be assured of his capabilities to verify the information included therein. This could not be achieved unless the audit committee member has sufficient educational and professional qualifications to enable him to understand entity activity and denotation of information present in financial statements (SOCPA).

In consideration of the above, the Saudi Certified Public Accountants (CPA), in Article (1/2) of its Project of Regulating the Audit Committee in Saudi Joint Stock Companies (2003), stated that the audit committee member must have an appropriate level of educational qualification and reasonable knowledge in accounting and financial matters. The Article also indicated that at least one member must have one of the following educational qualifications: a doctorate in accounting with two years experience in the field of accounting and/or auditing area (which could be reduced to one year if the member holds the Saudi CPA), a master in accounting with five years experience in the field of accounting and/or auditing area (which could be reduced to three years if the member holds the Saudi CPA) or a bachelor in accounting with seven years experience in the field of accounting and/or auditing area (which could be reduced to five years if the member holds the Saudi CPA) (Saudi Organization for Certified Public Accountants, SOCPA, 2003).

Obviously, Table 7-18 shows that none of the responding audit committee members had a masters' degree or a doctoral degree in accounting, however, 26 members had their bachelor in accounting. The Article (1/2) states that audit committee members with bachelor in accounting must have seven years experience. The next Table (7-19) illustrates the experience that the participants had. Since none of the audit committee members had a master or doctoral degree in accounting, those members with bachelor in accounting must have at least seven years experience in the field if they do not have a CPA certificate or five years if they do. Table 7-19 shows that only 6 (14%) audit committee members with bachelor degrees had five years or less experience. Due to the confidentiality associated with the questionnaires, the researcher was not able to investigate whether each audit committee had at least one member with the qualification and experience specified by the SOCPA.

Table 7-19 Audit Committee Member * Experience Cross-tabulation

Category of Respondent	Qualification	Experience						Total
		≤ 5	6-10	11-15	16-20	21-25	26 ≥	
Board Member	< High School	-	1	-	-	-	2	3
	Bachelor	2	9	-	4	-	8	23
	Master	2	2	-	-	-	4	8
	Doctoral	-	-	2	2	-	-	4
	Other	-	-	2	-	-	4	6
Total		**4**	**12**	**4**	**6**	**-**	**18**	**44**
CEO	Bachelor	1	-	-	2	4	3	10
	Master	1	-	-	-	-	1	2
	Doctoral	-	-	1	-	-	-	1
	Other	-	-	-	-	-	2	2
Total		**2**	**-**	**1**	**2**	**4**	**6**	**15**
Audit Committee Member	Bachelor	6	16	6	8	-	8	44
	Master	4	-	-	-	-	2	6
	Other	-	-	-	-	-	4	4
Total		**10**	**16**	**6**	**8**	**-**	**14**	**54**
Overall Total		**16**	**28**	**11**	**16**	**4**	**38**	**113**

7.5. MEASURING LOCATION 'Central Tendency'

The frequency distribution analysed above presented information about the shape of a distribution of scores and the range of the scores obtained from the four participating groups (the board members, etc.). Often, however, a researcher needs to describe a distribution of scores with only one number (Kiess, 2002). In different words, the researcher may need to deal with this type of issue: if you were to pick one number that could best describe all the data in a set, what number would you pick?

The description of a variable usually begins with the specification of its single most representative value, often called the measure of location, or central tendency. A measure of location or central tendency is a convenient way of describing a large frequency distribution by means of a single value (Collis and Hussey, 2003). Measures of central tendency are measures of the location of the middle or the centre of a distribution. The definition of "middle" or "centre" is purposely left somewhat vague so that the term "central tendency" can refer to a wide variety of measures. The main measures of location in common use are: the mean, the mid-range, the median and the mode (Weiers, 2005; Kiess, 2002; Collis et al., 2003).

The mean ($\bar{x}$), which is merely the average of the data, is the most widely used measure of central tendency (Weiers, 2005; Kiess, 2002). The arithmetic mean is defined as the sum of the data values divided by the number of observations (Weiers, 2005). If $\bar{x}$= mean, **x** = an observation and **N**= total number of observations, then:

$$\bar{x} = \frac{x_1 + x_2 + x_3 + \ldots + x_N}{N} = \frac{1}{N}\sum_{i=1}^{N} x_i$$

The mid-range of a set of data is simply the sum of the smallest and the largest values divided by 2. The median of a set of data is the value in the centre of the data values when they are arranged from smallest to largest (Collis et al, 2003). The mode is a value that occurs with the greatest frequency (Kiess, 2002).

It is clear that the mean, the mid-range, the median and the mode are alternative approaches to describing the central tendency of a set of values. In deciding which measure to use in the current research, a number of considerations has been involved. First, the mean is able to make more complete use of the data since it gives equal consideration to even very extreme values while the median and the mid-range focus more closely on the middle of the data array. Second, there may be more than one mode if several numbers occur the same number of times and there may be no mode if all values occur only once. Finally, the mean is easy to compute and explain, and it has several mathematical properties that make it more advantageous to use than the other three measures of central tendency (median – mid-range - mode). Therefore, it could be concluded that while the researcher concentrate more on the mean, the median, mid-range and the mode will be used less frequently in the frequencies and percentages of the respondents' data illustrated in the next sections.

7.5.1. Frequencies and Percentages of the Board Members' Attitudes Toward Each Statement in the Questionnaire

For ease of reference, the discussion regarding the participants' attitudes towards corporate governance effectiveness has been divided to correspond with the four sections of the questionnaire. The questionnaire was divided into four group statements: shareholders, board of directors, audit committee and disclosure and transparency. Each participant (shareholder, board member, etc.) was asked to provide his opinion (based on 5-point Likret Scale) to each statement under each of the four groups according to the actual practice in order to get his attitude towards how effective corporate governance in Saudi joint stock companies is, which is the core research question investigated in this thesis.

Table 7-20 presents the frequencies and percentages of the responses obtained from the board members toward each statement in the questionnaire. It should be noted that the number of the respondents from the first group (board members) is 44. Therefore the total number of the board members' responses (#) to each statement (row) must be 44, given that no missing values were involved, and the total of percentages (%) to each statement (row) must be 100 per cent.

Table 7-20 Frequencies and Percentages of the Board Members' Responses to Each Statement in the Questionnaire

Statement No	Statements	St. Disagree		Disagree		Neither		Agree		St. Agree		Mean
		No	%	No	%	No	%	No	%	No	%	
7.20 .A	**Shareholders Rights:**	#	%	#	%	#	%	#	%	#	%	$\bar{x}$
7.20. A.1	Shareholders have secure methods of ownership registration	-	-	-	-	-	-	24	55	20	45	**4.45**
7.20. A.2	Shareholders are able to practise their rights	-	-	-	-	-	-	18	41	26	59	**4.59**
7.20. A.3	Shareholders obtain timely and regular information on the corporation	-	-	2	4	8	18	28	64	6	14	**3.86**
7.20. A.4	Shareholders understand their rights	-	-	10	23	14	32	16	36	4	9	**3.32**
A.5	Shareholders care about attending general meetings	-	-	20	45	2	5	18	41	4	9	**3.14**
7.20. A.6	Shareholders are furnished with sufficient and timely information concerning general meetings (date, location and agenda)	-	-	4	9	-	-	26	59	14	32	**4.14**

7.20. A.7	Shareholders participate in the general meeting discussion and ask questions to the board members	-	-	4	9	-	-	24	55	16	36	**4.18**
7.20. A.8	Shareholders vote in general meetings and place items on the agenda	-	-	2	5	2	5	24	54	16	36	**4.23**
7.20. A.9	Shareholders share in the profits of the corporation	-	-	2	5	-	-	22	50	20	45	**4.36**
7.20. A.10	Shareholders elect members of the board	2	5	-	-	6	13	22	50	14	32	**4.05**
7.20. A.11	All shareholders of the same class are treated equally	-	-	2	5	12	27	20	45	10	23	**3.86**
7.20. A.12	Within any class, all shareholders have the same voting rights	-	-	6	14	8	18	20	45	10	23	**3.77**
7.20. A.13	Procedures for general meetings allow for equitable treatment of all shareholders	-	-	-	-	4	9	24	55	16	36	**4.27**
7.20. A.14	Insider trading and abusive self-dealing are prohibited	-	-	8	18	4	9	12	27	20	46	**4.00**
7.20. A.15	Generally, shareholders get their rights	-	-	-	-	2	5	32	73	10	23	**4.18**
	Overall (7.20.A) Mean											**4.03**
7.20 .B	**Board of Directors:**	#	%	#	%	#	%	#	%	#	%	$\bar{x}$
7.20. B.1	The board of directors monitors the management	-	-	4	9	4	9	24	55	12	27	**4.00**
7.20. B.2	The board members act on a fully informed basis, in good faith, with due diligence and care, and in the best interest of the company and the shareholders	-	-	-	-	-	-	34	77	10	23	**4.23**
7.20. B.3	The board treats all shareholders fairly and equally	-	-	-	-	4	9	22	50	18	41	**4.32**
7.20. B.4	There are at least three non-executive members in the board	-	-	4	9	10	23	20	45	10	23	**3.82**
7.20. B.5	The board ensures compliance with applicable law and take into account the interests of stakeholders	-	-	-	-	2	5	26	59	16	36	**4.32**
7.20. B.6	The board members fulfil their expected key functions including: Reviewing and guiding corporate strategy	-	-	2	5	2	5	30	68	10	22	**4.09**
7.20. B.7	Setting performance objectives	-	-	2	5	-	-	32	72	10	22	**4.14**
7.20. B.8	Overseeing the process of disclosure and communications	-	-	-	-	8	18	26	59	10	23	**4.05**
7.20. B.9	Ensuring the integrity of the corporation's accounting and financial reporting systems	-	-	-	-	4	9	28	64	12	27	**4.18**

7.20. B.10	Board members do not provide consultation to their company and are not affiliated with a company that is an adviser or consultant to the company or senior management	-	-	12	27	12	27	8	19	12	27	**3.45**
7.20. B.11	Board members are not affiliated with a significant customer or supplier	2	5	8	18	4	9	18	41	12	27	**3.68**
7.20. B.12	There is an independent board committee for remuneration	8	18	8	18	8	18	20	46	-	-	**2.91**
7.20. B.13	There is an independent board committee for nomination	8	18	8	18	8	18	20	46	-	-	**2.91**
7.20. B.14	There is an independent board committee for auditing	-	-	2	4	-	-	32	73	10	23	**4.14**
7.20. B.15	The roles of the chief executive officer and the chairman of the board of directors are separated	-	-	10	23	2	5	20	45	12	27	**3.77**
7.20. B.16	The board members devote sufficient time to their responsibilities and attend at least 75% of meetings, on average.	-	-	-	-	-	-	32	73	12	27	**4.27**
7.20. B.17	The firm holds four or more regular board meetings per year	-	-	-	-	2	5	26	59	16	36	**4.32**
7.20. B.18	The board members have access to accurate, relevant and timely information	-	-	-	-	2	5	28	63	14	32	**4.27**
7.20. B.19	Generally, the board of directors is effective	-	-	-	-	-	-	30	68	16	32	**4.32**
Overall (7.20.B) Mean												**3.96**
7.20 .C	**Audit Committee:**	#	%	#	%	#	%	#	%	#	%	x̄
7.20. C.1	Audit committee exists and is independent from management	-	-	-	-	4	9	32	73	8	18	**4.09**
7.20. C.2	The audit committee monitor and review the effectiveness of the company's internal audit function	-	-	4	9	16	36	18	41	6	14	**3.59**
7.20. C.3	The audit committee approves the appointment and replacement of the internal audit head and discusses with him related matters	2	5	14	32	16	36	12	27	-	-	**2.86**
7.20. C.4	The audit committee makes recommendations to the board in relation to the appointment of the external auditor, his remuneration and terms of engagement	-	-	-	-	8	18	22	50	14	32	**4.14**

7.20. C.5	The audit committee reviews and monitors the integrity of the financial statements of the company before they are approved by the board of directors and publicly disseminated to ensure their objectiveness, accuracy, and timeliness	-	-	-	-	8	18	26	59	10	23	**4.05**
7.20. C.6	There are at least four members in the audit committee	2	5	12	27	16	36	10	23	4	9	**3.05**
7.20. C.7	Audit committee includes someone with expertise in accounting and auditing	-	-	2	5	6	14	28	63	8	18	**3.95**
7.20. C.8	The committee members understand the audit committee functions	-	-	2	5	4	9	32	72	6	14	**3.95**
7.20. C.9	Audit committee meets at least four times a year	-	-	-	-	8	18	26	59	10	23	**4.05**
7.20. C.10	Audit committee member attend at least 75% of meetings, on average	-	-	-	-	6	14	28	63	10	23	**4.09**
7.20. C.11	Agenda and related material are provided to members ahead of meetings	-	-	-	-	8	18	26	59	10	23	**4.05**
7.20. C.12	Report on audit committee's activities provided at annual shareholder meeting	-	-	4	9	18	41	18	41	4	9	**3.50**
7.20. C.13	Audit committee has access to relevant information	-	-	-	-	12	27	22	50	10	23	**3.95**
7.20. C.14	Objectives, responsibilities and authority of the audit committee are clearly defined in a written statement (charter)	-	-	-	-	14	32	20	45	10	23	**3.91**
7.20. C.15	Generally, the audit committee is effective	-	-	-	-	8	18	30	68	6	14	**3.95**
Overall (7.20.C) Mean												**3.81**
7.20 .D	**Disclosure and Transparency:**	#	%	#	%	#	%	#	%	#	%	$\bar{x}$
7.20. D.1	Disclosure and transparency are of high priority in the company	-	-	2	5	6	14	28	63	8	18	**3.95**
7.20. D.2	The company discloses the company's objectives and policies	-	-	-	-	4	9	30	68	10	23	**4.14**
7.20. D.3	The company discloses the financial statements and information in the newspaper	-	-	-	-	4	9	20	45	20	46	**4.36**
7.20. D.4	The company has a website in the Internet	-	-	2	5	12	27	16	36	14	32	**3.95**
7.20. D.5	The company discloses the financial and operating results of the company in Arabic	-	-	-	-	4	9	26	59	14	32	**4.23**
7.20. D.6	The company discloses the financial and operating results of the company in English	-	-	10	23	14	32	18	41	2	4	**3.27**

7.20. D.7	The company discloses major share ownership and voting rights	-	-	-	-	8	18	22	50	14	32	**4.14**
7.20. D.8	The company discloses members of the board and key executives	-	-	-	-	6	14	24	54	14	32	**4.18**
7.20. D.9	The company discloses the remuneration of the board members	-	-	-	-	6	14	28	63	10	23	**4.09**
7.20. D.10	The company discloses material foreseeable risk factors	-	-	2	4	14	32	18	41	10	23	**3.82**
7.20. D.11	The company discloses material issues regarding employees and other stakeholders	-	-	2	5	16	36	16	36	10	23	**3.77**
7.20. D.12	The company discloses governance structures	-	-	-	-	16	36	20	46	8	18	**3.82**
7.20. D.13	The company's information is prepared, audited and disclosed in accordance with the standards of accounting, financial and non-financial disclosure accepted by the Saudi Government	-	-	-	-	8	18	26	59	10	23	**4.05**
7.20. D.14	Channels for disseminating information provide for fair, timely and cost-efficient access to relevant information by users	-	-	2	5	14	32	20	45	8	18	**3.77**
7.20. D.15	Generally, the firm's disclosure and transparency are effective	-	-	-	-	6	14	28	63	10	23	**4.09**
Overall (7.20.D) Mean												**3.98**
Overall (7.20.A, 7.20.B, 7.20.C, 7.20.D) Mean												**3.95**

In respect to the first group of statements (Group 7.20.A) in Table 7-20 that relates to the rights of shareholders, it could be noticed that the board members reacted positively to the first two Statements (7.20.A.1 and 7.20.A.2). Admitting that the registration of shares is the responsibility of the company, all board members agreed that shareholders have secure methods of ownership registration and are able to practise their rights. The next Statement (7.20.A.3), on whether shareholders obtain timely and regular information on the corporation, was not totally agreed upon. Two board members (4%) disagree, eight members were indifferent and 34 members agreed to this statement.

Only 45 per cent of the board members agreed with the next Statement (7.20.A.4), which was about whether shareholders understand their rights. Shareholders may not want detailed information on every law, however, it is important for shareholders to know their basic rights. The next four Statements (7.20.A.5, 7.20.A.6, 7.20.A.7 and 7.20.A.8) related to general meetings. About 90 per cent of the board members agreed that shareholders are furnished with information regarding general meetings (7.20.A.6), participate in the meeting discussion (7.20.A.7) and vote in general meetings (7.20.A.8). However, in regards of whether shareholder care about attending general meetings (7.20.A.5), only 50 per cent of board members agreed.

About 95 per cent of the participating board members agreed with Statement 7.20.A.9 that shareholders share in the profit, however, 5 per cent of members disagreed. Statement 7.20.A.10 also had a positive reaction since 82 per cent of board members agreed that shareholders elect members of the board.

More than 65 per cent of the board members agreed that shareholders of the same class are treated equally (7.20.A.11) and all shareholders within any class have the same voting rights (7.20.A.12). Also 91 per cent of board members agreed that the procedures for general meetings allow for equitable treatment of all shareholders (7.20.A.13). In regards of the statement related to the insider trading (7.20.A.14), 73 per cent of board members agreed that insider trading is totally prohibited. Finally, the final Statement (7.20.A.15) has been chosen to be general to cover the not previously mentioned thoughts of the participant in the statements about the rights of shareholders. It could be seen from Table 7-20 that about 95 per cent of the board members generally were more confident that shareholders get their expected rights.

The second group of statements (Group 7.20.B) relating to the board of directors in Table 7-20 represents an evaluation of themselves and the role they play in Saudi joint stock companies. The board members positively reacted to all statements except for Statements 7.20.B.10, 7.20.B.12 and 7.20.B.13 that had only 46 per cent of the board members agreed upon. The Statement 7.20.B.10 related to whether board members provide consultation to their company and/or affiliate with a company that is an adviser or consultant to the company or senior management. About 27 per cent of the participants disagreed with this statement, 27 per cent were indifferent and 46 per cent agreed. The other two Statements (7.20.B.12 and 7.20.B.13) were about the existence of a board committee for remuneration and nomination. About 36 per cent disagreed to these statements confirming that these committees do not exist, 8 per cent were moderately and 46 per cent agreed.

On the other hand, the board members agreed on the remaining 16 statements in the Group 7.20.B and the agreements fluctuated between 70 to 100 per cent to all statements. The participants' attitudes toward the second Statement (7.20.B.2), related to whether the board members act on a fully informed basis in good faith with due diligence and care and in the best interest of the company and the shareholders, were positive since all board members (100%) agreed to this statement. Statement 7.20.B.15 was to see whether the role of the chief executive officer and the chairman of the board were separated. About 23 per cent disagree and 72 per cent agreed to this statement. In regards of Statement 7.20.B.18, 95 per cent of the board members agreed that the board members have access to accurate, relevant and timely information, however, 5 per cent were not sure. In the final general Statement (7.20.B.19) relating to general impression of the board members towards the effectiveness of the board of directors in general, a 100 per cent of board members said that the board of directors is generally effective in Saudi joint stock sector. The mostly high percentage agreement to the statements in this group indicates that the board members are satisfied about themselves and about the way Saudi joint stock corporations are controlled by board members.

In respect to the statements of the third group (Group 7.20.C) in Table 7-20, which relate to the audit committee effectiveness, the frequencies and percentages of the participants' (the board members') responses were mostly positive. The board members' agreements fluctuated between 70 to 90 per cent to 11 Statements (7.20.C.1, 7.20.C.2, 7.20.C.4, 7.20.C.5, 7.20.C.7, 7.20.C.8, 7.20.C.9, 7.20.C.10, 7.20.C.11, 7.20.C.13, 7.20.C.14 and 7.20.C.15) out of 15 in this group. Although one clear responsibility of the audit committee is to make recommendations to the board of directors on the appointment, reappointment or replacement, remuneration, monitoring of the effectiveness, and independence of the external auditors, Statement C3, which states whether audit committee approves the appointment and replacement of the external auditor, had only 27 per cent agreement, 37 per cent disagreement and 36 per cent indifferent opinion by the participating board members.

Also, 32 per cent of the board members did not agree to Statement 7.20.C.6 stating that there are at least four members in the audit committee. This disagreement is violation to the Article 2-1 of the Project of Regulating Audit Committees in the

Saudi Joint Stock Companies issued by the Saudi Organization for Certified Public Accountants, which states that there must be at least four members in the audit committee (SOCPA, 2003). Only 32 per cent of the board members agreed to this statement, 7.20.C.6. In regard of the final negative response by the board members, about 41 per cent of the board members were indifferent in their responses to Statement 7.20.C.12, which was related to whether a report on audit committee's activities was provided at annual shareholder meetings, and 9 per cent of the participants disagreed.

The final group of statements (Group 7.20.D) in Table 7-20 related to disclosure and transparency. None of the statements had 100 per cent agreement, however, 9 statements had at least 80 per cent agreement (7.20.D.1, 7.20.D.2, 7.20.D.3, 7.20.D.5, 7.20.D.7, 7.20.D.8, 7.20.D.9, 7.20.D.13 and 7.20.D.15). An expected not agreeable Statement was number 7.20.D.6 which was the weakest statement with only 45 per cent agreement. This statement was to check whether the companies disclose their financial and operating results in the English language. Statement 7.20.D.5, which had about 91 per cent agreement, was exactly the same, however, the disclosure was in Arabic. It could be concluded that in respect to the board members, 91 per cent of the participants agreed that their companies as well as other joint stock companies in Saudi Arabia disclose their financial and operating results in Arabic but only 45 per cent of the companies disclose in English. The Internet technology is accelerating a decades-old trend for securities markets to become transnational in scope and character. It could be realised from the responses to the Statements 7.20.D.5 and 7.20.D.6 that Saudi joint stock companies are intending to provide information to the Saudi Investors in Arabic, however, the international investors using the Internet and wishing to participate directly in foreign capital markets no longer necessarily require the services of regulated intermediaries. That raises the spectre of potential liability to disclose in English under the securities laws of Saudi joint stock companies. The responses to the Statement 7.20.D.4, which seeks whether the company has a website in the Internet or not, were encouraging where 68 per cent agreed to this Statement and only 5 per cent disagreed.

7.5.2. Frequencies and Percentages of the Chief Executive Officers' Attitudes Toward Each Statement in the Questionnaire

Table 7-21 presents the frequencies and percentages of the responses obtained from the chief executive officers (CEOs) towards each statement in the questionnaire. It should be noted that the number of the respondents from the second group (CEOs) is 15. Therefore the total number of the chief executive officers' responses (#) to each statement (row) must be 15, given that no missing values were involved, and the total of percentages (%) to each statement (row) must be 100 per cent.

Table 7-21 Frequencies and Percentages of the Chief Executive Officers' Responses to Each Statement in the Questionnaire

Statement No	Statements	St. Disagree		Disagree		Neither		Agree		St. Agree		Mean
		No	%	No	%	No	%	No	%	No	%	
7.21 .A	**Shareholders Rights:**	#	%	#	%	#	%	#	%	#	%	$\bar{x}$
7.21. A.1	Shareholders have secure methods of ownership registration	-	-	-	-	-	-	7	47	8	53	**4.53**
7.21. A.2	Shareholders are able to practise their rights	-	-	-	-	-	-	5	33	10	67	**4.67**
7.21. A.3	Shareholders obtain timely and regular information on the corporation	-	-	1	7	1	7	11	73	2	13	**3.93**
7.21. A.4	Shareholders understand their rights	-	-	3	20	6	40	5	33	1	7	**3.27**
7.21. A.5	Shareholders care about attending general meetings	3	20	4	26	4	27	4	27	-	-	**2.60**
7.21. A.6	Shareholders are furnished with sufficient and timely information concerning general meetings (date, location and agenda)	-	-	-	-	-	-	6	40	9	60	**4.60**
7.21. A.7	Shareholders participate in the general meeting discussion and ask questions to the board members	-	-	-	-	1	7	7	46	7	47	**4.40**
7.21. A.8	Shareholders vote in general meetings and place items on the agenda	-	-	-	-	2	13	7	47	6	40	**4.27**
7.21. A.9	Shareholders share in the profits of the corporation	-	-	-	-	2	13	6	40	7	47	**4.33**
7.21. A.10	Shareholders elect members of the board	-	-	1	7	3	20	4	27	7	46	**4.13**

7.21. A.11		All shareholders of the same class are treated equally	-	-	-	-	2	13	7	47	6	40	**4.27**
7.21. A.12		Within any class, all shareholders have the same voting rights	-	-	1	7	1	7	7	46	6	40	**4.20**
7.21. A.13		Procedures for general meetings allow for equitable treatment of all shareholders	-	-	-	-	-	-	8	53	7	47	**4.47**
7.21. A.14		Insider trading and abusive self-dealing are prohibited	-	-	3	20	1	7	4	27	7	46	**4.00**
7.21. A.15		Generally, shareholders get their rights	-	-	-	-	2	13	11	74	2	13	**4.00**
Overall (7.21.A) Mean													**4.11**
7.21 .B		**Board of Directors:**	**#**	**%**	**#**	**%**	**#**	**%**	**#**	**%**	**#**	**%**	$\bar{x}$
7.21. B.1		The board of directors monitors the management	-	-	-	-	1	7	9	60	5	33	**4.27**
7.21. B.2		The board members act on a fully informed basis, in good faith, with due diligence and care, and in the best interest of the company and the shareholders	-	-	1	7	2	13	9	60	3	20	**3.93**
7.21. B.3		The board treats all shareholders fairly and equally	-	-	1	7	-	-	10	66	4	27	**4.13**
7.21. B.4		There are at least three non-executive members in the board	-	-	2	13	1	7	8	53	4	27	**3.93**
7.21. B.5		The board ensures compliance with applicable law and take into account the interests of stakeholders	-	-	-	-	2	13	11	74	2	13	**4.00**
7.21. B.6	The board members fulfil their expected key functions including	Reviewing and guiding corporate strategy	-	-	-	-	2	13	9	60	4	27	**4.13**
7.21. B.7		Setting performance objectives	-	-	-	-	1	7	10	66	4	27	**4.20**
7.21. B.8		Overseeing the process of disclosure and communications	-	-	-	-	2	13	9	60	4	27	**4.13**
7.21. B.9		Ensuring the integrity of the corporation's accounting and financial reporting systems	-	-	-	-	2	13	8	53	5	34	**4.20**
7.21. B.10		Board members do not provide consultation to their company and are not affiliated with a company that is an adviser or consultant to the company or senior management	-	-	2	13	4	27	8	53	1	7	**3.53**
7.21. B.11		Board members are not affiliated with a significant customer or supplier	-	-	4	27	4	27	5	33	2	13	**3.33**
7.21. B.12		There is an independent board committee for remuneration	3	20	4	27	1	7	5	33	2	13	**2.93**
7.21. B.13		There is an independent board committee for nomination	3	20	4	27	3	20	4	26	1	7	**2.73**

7.21. B.14	There is an independent board committee for auditing	-	-	1	7	1	7	6	40	7	46	**4.27**
7.21. B.15	The roles of the chief executive officer and the chairman of the board of directors are separated	-	-	2	13	2	13	7	47	4	27	**3.87**
7.21. B.16	The board members devote sufficient time to their responsibilities and attend at least 75% of meetings, on average.	-	-	-	-	-	-	14	93	1	7	**4.07**
7.21. B.17	The firm holds four or more regular board meetings per year	-	-	1	7	1	7	6	40	7	46	**4.27**
7.21. B.18	The board members have access to accurate, relevant and timely information	-	-	-	-	-	-	8	53	7	47	**4.47**
7.21. B.19	Generally, the board of directors is effective	-	-	-	-	1	7	11	73	3	20	**4.13**
Overall (7.21.B) Mean												**3.92**
7.21 .C	**Audit Committee:**	#	%	#	%	#	%	#	%	#	%	$\bar{x}$
7.21. C.1	Audit committee exists and is independent from management	-	-	-	-	1	7	10	66	4	27	**4.20**
7.21. C.2	The audit committee monitor and review the effectiveness of the company's internal audit function	-	-	-	-	4	27	8	53	3	20	**3.93**
7.21. C.3	The audit committee approves the appointment and replacement of the internal audit head and discusses with him related matters	1	7	1	7	6	40	7	46	-	-	**3.27**
7.21. C.4	The audit committee makes recommendations to the board in relation to the appointment of the external auditor, his remuneration and terms of engagement	-	-	-	-	2	13	7	47	6	40	**4.27**
7.21. C.5	The audit committee reviews and monitors the integrity of the financial statements of the company before they are approved by the board of directors and publicly disseminated to ensure their objectiveness, accuracy, and timeliness	-	-	2	13	1	7	9	60	3	20	**3.87**
7.21. C.6	There are at least four members in the audit committee	1	7	6	40	3	20	3	20	2	13	**2.93**
7.21. C.7	Audit committee includes someone with expertise in accounting and auditing	-	-	1	7	2	13	8	53	4	27	**4.00**
7.21. C.8	The committee members understand the audit committee functions	-	-	-	-	4	27	7	46	4	27	**4.00**
7.21. C.9	Audit committee meets at least four times a year	-	-	2	13	1	7	7	47	5	33	**4.00**

7.21. C.10	Audit committee member attend at least 75% of meetings, on average	-	-	-	-	2	13	7	47	6	40	**4.27**
7.21. C.11	Agenda and related material are provided to members ahead of meetings	-	-	-	-	3	20	10	67	2	13	**3.93**
7.21. C.12	Report on audit committee's activities provided at annual shareholder meeting	-	-	4	27	5	33	6	40	-	-	**3.13**
7.21. C.13	Audit committee has access to relevant information	-	-	1	7	2	13	10	67	2	13	**3.87**
7.21. C.14	Objectives, responsibilities and authority of the audit committee are clearly defined in a written statement (charter)	-	-	-	-	2	13	12	80	1	7	**3.93**
7.21. C.15	Generally, the audit committee is effective	-	-	1	7	4	27	6	40	4	26	**3.87**
Overall (7.21.C) Mean												**3.83**

7.21 .D	**Disclosure and Transparency:**	#	%	#	%	#	%	#	%	#	%	$\bar{x}$
7.21. D.1	Disclosure and transparency are of high priority in the company	-	-	-	-	1	7	11	73	3	20	**4.13**
7.21. D.2	The company discloses the company's objectives and policies	-	-	-	-	3	20	8	53	4	27	**4.07**
7.21. D.3	The company discloses the financial statements and information in the newspaper	-	-	-	-	-	-	7	47	8	53	**4.53**
7.21. D.4	The company has a website in the Internet	-	-	1	7	1	7	8	53	5	33	**4.13**
7.21. D.5	The company discloses the financial and operating results of the company in Arabic	-	-	1	7	-	-	8	53	6	40	**4.27**
7.21. D.6	The company discloses the financial and operating results of the company in English	-	-	4	27	2	13	8	53	1	7	**3.40**
7.21. D.7	The company discloses major share ownership and voting rights	-	-	-	-	2	13	10	67	3	20	**4.07**
7.21. D.8	The company discloses members of the board and key executives	-	-	-	-	1	7	11	73	3	20	**4.13**
7.21. D.9	The company discloses the remuneration of the board members	-	-	-	-	1	7	8	53	6	40	**4.33**
7.21. D.10	The company discloses material foreseeable risk factors	-	-	2	13	2	13	9	60	2	14	**3.73**
7.21. D.11	The company discloses material issues regarding employees and other stakeholders	-	-	-	-	5	33	8	53	2	14	**3.80**
7.21. D.12	The company discloses governance structures	-	-	-	-	3	20	7	47	5	33	**4.13**

7.21. D.13	The company's information is prepared, audited and disclosed in accordance with the standards of accounting, financial and non-financial disclosure accepted by the Saudi Government	-	-	-	-	-	-	8	53	7	47	**4.47**
7.21. D.14	Channels for disseminating information provide for fair, timely and cost-efficient access to relevant information by users	-	-	-	-	2	14	8	53	5	33	**4.20**
7.21. D.15	Generally, the firm's disclosure and transparency are effective	-	-	-	-	2	13	9	60	4	27	**4.13**
Overall (7.21.D) Mean												**4.10**
Overall (7.21.A, 7.21.B, 7.21.C, 7.21.D) Mean												**3.99**

The first group of statements (Group 7.21.A) in Table 7-21 was intended to get the chief executive officers', the highest-ranking executives in a company or organization who are responsible for carrying out the policies of the board of directors on a day-to-day basis, attitudes towards the shareholder rights, again according to the actual practice not the best practice in Saudi joint stock corporations. At a general look at all the responses to all the 15 statements in the Group 7.21.A, it could be noticed that the chief executive officers (CEOs) attitudes seem to be positive. The agreements were between 80 per cent and 100 per cent to about 13 Statements (7.21.A.1, 7.21.A.2, 7.21.A.3, 7.21.A.6, 7.21.A.7, 7.21.A.8, 7.21.A.9, 7.21.A.10, 7.21.A.11, 7.21.A.12, 7.21.A.13, 7.21.A.14 and 7.21.A.15) out of 15 statements total (Table 7-21). This high percentage of agreement indicates that the chief executive officers are satisfied that shareholders are getting their expected rights in Saudi Arabia.

The other two Statements (7.21.A.4 and 7.21.A.5) got only 40 and 27 per cent agreement, respectively. About 40 per cent of the CEOs agreed to Statement 7.21.A.4, shareholders understand their rights, 40 per cent were not sure and 20 per cent disagreed. The weakest statement with the minimum agreement in this group is Statement 7.21.A.5, with only 27 per cent agreement, 27 per cent not sure and 46 per cent disagreement. If shareholders understand their rights and understand the key aspects of company strategy and performance, they can participate more fully in the annual general meetings and can maintain the focus on company performance, transparency and board accountability. More educated shareholders will, with time, lead to a more viable, active capital market.

The second group of statements (Group 7.21.B) in Table 7-21 was intended to get the vision of the chief executive officers towards the board members. The responses to the Statements 7.21.B.1, 7.21.B.2, 7.21.B.3, 7.21.B.4, 7.21.B.5, 7.21.B.6, 7.21.B.7, 7.21.B.8, 7.21.B.9, 7.21.B.14, 7.21.B.15, 7.21.B.16, 7.21.B.17, 7.21.B.18 and 7.21.B.19 were above 80 per cent agreement, whereas the responses to the rest (7.21.B.10, 7.21.B.11, 7.21.B.12 and 7.21.B.13) were 60, 46, 46 and 33, respectively. The Statement 7.21.B.10, which states that board members do not provide consultation to their company and are not affiliated with a company that is an advisor or consultant to the company or senior management, with 60 per cent agreement and 13 per cent disagreement as well as the low agreement to the next Statement 7.21.B.11 doubt on the independence of the board of directors' members. About 47 per cent of the chief executive officers were not agreeing that there are board committees for nomination (Statement 7.21.B.13) and remuneration (Statement 7.21.B.12) in Saudi Arabia.

Group (7.21.C) in Table 7-21 relates to the evaluation of the chief executive officers of the audit committee in Saudi joint stock corporations. The responses to the Statements 7.21.C.1, 7.21.C.2, 7.21.C.4, 7.21.C.5, 7.21.C.7, 7.21.C.8, 7.21.C.9, 7.21.C.10, 7.21.C.11, 7.21.C.13, 7.21.C.14 and 7.21.C.15 were not worrying. However, the other three statements with less agreement should be considered. About 40 per cent of the CEOs were indifferent toward the Statement 7.21.C.3, the audit committee approves the appointment and replacement of the internal audit head and discusses with him related matters, 14 per cent disagree and 46 per cent agree to this statement. Although the Project of Regulating Audit Committees in Saudi Joint Stock Companies (2003) states in the Article (2-1) that there must be at least 4 members in the audit committee (SOCPA, 2003), the responses of the chief executive officers (47% disagree, 20% not sure and 33% agree) to the Statement 7.21.C.6 (there are at least four members in the audit committee) indicates a clear violation. Finally, 27 per cent of the CEOs disagree to Statement 7.21.C.12 (reports on audit committee's activities provided at annual shareholder meetings), 33 per cent were not sure and 40 per cent agree.

The final group of statements (Group 7.21.D) in Table 7-21 was to evaluate the disclosure and transparency in the chief executive officers' perspectives. Obviously, the agreements of the respondents to these statements were relatively high. At least twelve chief executive officers (80%) agreed to the Statements 7.21.D.1, 7.21.D.2, 7.21.D.3, 7.21.D.4, 7.21.D.5, 7.21.D.7, 7.21.D.8, 7.21.D.9, 7.21.D.12, 7.21.D.13, 7.21.D.14 and 7.21.D.15. Although the other three statements did not have such high agreement percentages, the agreement was still between 60 and 80 per cent. The two statements with 100 per cent agreement from all chief executive officers were 7.21.D.3 (the company discloses the financial statements and information in the newspaper) and 7.21.D.13 (the company's information is prepared, audited and disclosed in accordance with the standards of accounting, financial and non-financial disclosure accepted by the Saudi government). However, the lowest percentage was to the Statement 7.21.D.6 (the company discloses the financial and operating results of the company in English), which was 60 per cent agreement.

7.5.3. Frequencies and Percentages of the Audit Committee Members' Attitudes Toward Each Statement in the Questionnaire

Table 7-22 presents the frequencies and percentages of the responses obtained from the audit committee members towards each statement in the questionnaire. It should be noted that the number of the respondents from the third group (audit committee members) is 54. Therefore the total number of the audit committee members' responses (#) to each statement (row) must be 54, given that no missing values were involved, and the total of percentages (%) to each statement (row) must be 100 per cent.

Table 7-22 Frequencies and Percentages of the Audit Committee Members' Responses to Each Statement in the Questionnaire

Statement No	Statements	St. Disagree		Disagree		Neither		Agree		St. Agree		Mean
		No	%	No	%	No	%	No	%	No	%	
7.22.A	**Shareholders Rights:**	#	%	#	%	#	%	#	%	#	%	$\bar{x}$
7.22.A.1	Shareholders have secure methods of ownership registration	-	-	6	11	2	4	28	52	18	33	**4.07**
7.22.A.2	Shareholders are able to practise their rights	-	-	-	-	-	-	24	44	30	56	**4.56**
7.22.A.3	Shareholders obtain timely and regular information on the corporation	6	11	4	7	12	22	28	52	4	8	**3.37**
7.22.A.4	Shareholders understand their rights	-	-	10	18	22	41	20	37	2	4	**3.26**
7.22.A.5	Shareholders care about attending general meetings	2	4	22	41	10	18	18	33	2	4	**2.93**
7.22.A.6	Shareholders are furnished with sufficient and timely information concerning general meetings (date, location and agenda)	4	7	6	11	6	11	30	56	8	15	**3.59**
7.22.A.7	Shareholders participate in the general meeting discussion and ask questions to the board members	2	4	4	8	10	18	28	52	10	18	**3.74**
7.22.A.8	Shareholders vote in general meetings and place items on the agenda	6	11	2	4	12	22	26	48	8	15	**3.52**
7.22.A.9	Shareholders share in the profits of the corporation	-	-	4	8	6	11	24	44	20	37	**4.11**
7.22.A.10	Shareholders elect members of the board	8	15	6	11	8	15	22	41	10	18	**3.37**
7.22.A.11	All shareholders of the same class are treated equally	2	4	6	11	12	22	30	56	4	7	**3.52**
7.22.A.12	Within any class, all shareholders have the same voting rights	4	8	8	15	12	22	24	44	6	11	**3.37**
7.22.A.13	Procedures for general meetings allow for equitable treatment of all shareholders	-	-	8	15	14	26	20	37	12	22	**3.67**
7.22.A.14	Insider trading and abusive self-dealing are prohibited	4	8	6	11	4	7	18	33	22	41	**3.89**
7.22.A.15	Generally, shareholders get their rights	-	-	6	11	16	30	28	52	4	7	**3.56**
	Overall (7.22.A) Mean											**3.64**
7.22.B	**Board of Directors:**	#	%	#	%	#	%	#	%	#	%	$\bar{x}$

7.22. B.1	The board of directors monitors the management		-	-	4	7	6	11	28	52	16	30	**4.04**
7.22. B.2	The board members act on a fully informed basis, in good faith, with due diligence and care, and in the best interest of the company and the shareholders		2	4	8	15	6	11	24	44	14	26	**3.74**
7.22. B.3	The board treats all shareholders fairly and equally		6	11	-	-	12	22	20	37	16	30	**3.74**
7.22. B.4	There are at least three non-executive members in the board		-	-	8	15	20	37	22	41	4	7	**3.41**
7.22. B.5	The board ensures compliance with applicable law and take into account the interests of stakeholders		-	-	8	15	4	7	32	59	10	19	**3.81**
7.22. B.6	The board members fulfil their expected key functions including	Reviewing and guiding corporate strategy	2	4	2	4	6	11	36	66	8	15	**3.85**
7.22. B.7		Setting performance objectives	2	4	2	4	10	18	32	59	8	15	**3.78**
7.22. B.8		Overseeing the process of disclosure and communications	-	-	2	4	16	29	28	52	8	15	**3.78**
7.22. B.9		Ensuring the integrity of the corporation's accounting and financial reporting systems	-	-	6	11	10	19	32	59	6	11	**3.70**
7.22. B.10	Board members do not provide consultation to their company and are not affiliated with a company that is an adviser or consultant to the company or senior management		2	4	12	22	12	22	18	33	10	19	**3.41**
7.22. B.11	Board members are not affiliated with a significant customer or supplier		12	22	6	12	12	22	12	22	12	22	**3.11**
7.22. B.12	There is an independent board committee for remuneration		4	8	18	33	18	33	10	19	4	7	**2.85**
7.22. B.13	There is an independent board committee for nomination		8	15	18	33	12	22	12	22	4	8	**2.74**
7.22. B.14	There is an independent board committee for auditing		2	4	6	11	4	7	30	56	12	22	**3.81**
7.22. B.15	The roles of the chief executive officer and the chairman of the board of directors are separated		8	15	6	11	2	4	22	40	16	30	**3.59**
7.22. B.16	The board members devote sufficient time to their responsibilities and attend at least 75% of meetings, on average.		6	11	-	-	14	26	28	52	6	11	**3.52**
7.22. B.17	The firm holds four or more regular board meetings per year		-	-	2	4	8	15	36	66	8	15	**3.93**
7.22. B.18	The board members have access to accurate, relevant and timely information		-	-	-	-	4	7	36	67	14	26	**4.19**
7.22. B.19	Generally, the board of directors is effective		-	-	8	15	10	19	24	44	12	22	**3.74**

Overall (7.22.B) Mean												3.62

7.22 .C	Audit Committee:	#	%	#	%	#	%	#	%	#	%	x̄
7.22. C.1	Audit committee exists and is independent from management	-	-	6	11	10	18	28	52	10	19	**3.78**
7.22. C.2	The audit committee monitor and review the effectiveness of the company's internal audit function	-	-	8	15	8	15	30	55	8	15	**3.70**
7.22. C.3	The audit committee approves the appointment and replacement of the internal audit head and discusses with him related matters	6	11	12	22	8	15	24	44	4	8	**3.15**
7.22. C.4	The audit committee makes recommendations to the board in relation to the appointment of the external auditor, his remuneration and terms of engagement	2	4	4	7	6	11	36	67	6	11	**3.74**
7.22. C.5	The audit committee reviews and monitors the integrity of the financial statements of the company before they are approved by the board of directors and publicly disseminated to ensure their objectiveness, accuracy, and timeliness	-	-	4	8	6	11	38	70	6	11	**3.85**
7.22. C.6	There are at least four members in the audit committee	-	-	18	33	26	48	8	15	2	4	**2.89**
7.22. C.7	Audit committee includes someone with expertise in accounting and auditing	2	4	10	18	8	15	18	33	16	30	**3.67**
7.22. C.8	The committee members understand the audit committee functions	-	-	4	8	12	22	32	59	6	11	**3.74**
7.22. C.9	Audit committee meets at least four times a year	-	-	2	4	10	18	36	67	6	11	**3.85**
7.22. C.10	Audit committee member attend at least 75% of meetings, on average	-	-	6	11	10	18	28	52	10	19	**3.78**
7.22. C.11	Agenda and related material are provided to members ahead of meetings	-	-	4	8	10	18	32	59	8	15	**3.81**
7.22. C.12	Report on audit committee's activities provided at annual shareholder meeting	-	-	-	-	14	26	38	70	2	4	**3.78**
7.22. C.13	Audit committee has access to relevant information	-	-	4	7	14	26	22	41	14	26	**3.85**
7.22. C.14	Objectives, responsibilities and authority of the audit committee are clearly defined in a written statement (charter)	-	-	4	7	14	26	22	41	14	26	**3.85**
7.22. C.15	Generally, the audit committee is effective	-	-	12	22	6	11	24	45	12	22	**3.67**

Overall (7.22.C) Mean												3.67
7.22 .D	**Disclosure and Transparency:**	#	%	#	%	#	%	#	%	#	%	x̄
7.22. D.1	Disclosure and transparency are of high priority in the company	2	4	10	18	10	19	26	48	6	11	**3.44**
7.22. D.2	The company discloses the company's objectives and policies	2	4	-	-	6	11	40	74	6	11	**3.89**
7.22. D.3	The company discloses the financial statements and information in the newspaper	-	-	-	-	4	7	34	63	16	30	**4.22**
7.22. D.4	The company has a website in the Internet	-	-	4	7	6	11	36	67	8	15	**3.89**
7.22. D.5	The company discloses the financial and operating results of the company in Arabic	-	-	2	4	4	7	38	70	10	19	**4.04**
7.22. D.6	The company discloses the financial and operating results of the company in English	-	-	12	22	20	37	20	37	2	4	**3.22**
7.22. D.7	The company discloses major share ownership and voting rights	-	-	8	15	12	22	28	52	6	11	**3.59**
7.22. D.8	The company discloses members of the board and key executives	-	-	2	4	10	18	36	67	6	11	**3.85**
7.22. D.9	The company discloses the remuneration of the board members	6	11	4	7	8	15	30	56	6	11	**3.48**
7.22. D.10	The company discloses material foreseeable risk factors	6	11	6	11	22	41	18	33	2	4	**3.07**
7.22. D.11	The company discloses material issues regarding employees and other stakeholders	2	4	4	8	20	37	24	44	4	7	**3.44**
7.22. D.12	The company discloses governance structures	2	4	8	15	16	30	24	44	4	7	**3.37**
7.22. D.13	The company's information is prepared, audited and disclosed in accordance with the standards of accounting, financial and non-financial disclosure accepted by the Saudi Government	2	4	6	11	6	11	30	56	10	18	**3.74**
7.22. D.14	Channels for disseminating information provide for fair, timely and cost-efficient access to relevant information by users	2	4	6	11	16	30	26	48	4	7	**3.44**
7.22. D.15	Generally, the firm's disclosure and transparency are effective	2	4	12	22	4	7	32	59	4	8	**3.44**
Overall (7.22.D) Mean												**3.61**
Overall (7.22.A, 7.22.B, 7.22.C, 7.22.D) Mean												**3.64**

It can be seen from Table 7-22, which summarises the responses of the third group on corporate governance (audit committee members) towards the statements regarding shareholder rights, etc., that the responses in general for all groups of statements spread widely between 1 (strongly disagree) and 5 (strongly agree) more than has been seen in the previous two groups (see Table 7-20 and 7-21).

In regards of the statements of the first group (Group 7.22.A: Shareholder Rights) in Table 7-22, the audit committee members' responses to these statements were above 70 per cent agreement to the following Statements: 7.22.A.1, 7.22.A.2, 7.22.A.6, 7.22.A.7, 7.22.A.9 and 7.22.A.14, whereas the agreements were less than 63 per cent for the rest of the statements. The Statements 7.22.A.4 (shareholders understand their rights) and 7.22.A.5 (shareholders care about attending general meetings) had the highest disagreement percentages, which were 37 and 41, respectively. Recall that the Statements 7.22.A.4 and 7.22.A.5 had low agreement percentages by the CEOs in Table 7-21 (40%and 45%) and low agreement percentages by the board members in Table 7-20 (27% and 50%). In order to allow shareholders to exercise greater control, they should first be better informed about their rights and the company's corporate governance practices. Although corporate governance is still in the developmental stage in Saudi Arabia and no best practices have been enforced yet, the Saudi Commission should require all listed companies to include in their annual documents a coherent and descriptive statement covering the key elements of their corporate governance structures and practices.

With respect to the statements of the role of the board members in effective corporate governance (Group 7.22.B) in Table 7-22, the agreement of the audit committee members toward these statements is almost the same as the first group. At least 35 audit committee members (65%) agreed to the following 14 Statements: 7.22.B.1, 7.22.B.2, 7.22.B.3, 7.22.B.5, 7.22.B.6, 7.22.B.7, 7.22.B.8, 7.22.B.9, 7.22.B.14, 7.22.B.15, 7.22.B.16, 7.22.B.17, 7.22.B.18 and 7.22.B.19. The agreement percentages of the audit committee members to these 14 Statements respectively were: 82%, 70%, 67%, 78%, 81%, 74%, 67%, 70%, 78%, 70%, 63%, 81%, 93% and 66%. Statements B12 and B13 had the lowest agreement percentages (26% and 30%) by the audit committee members. That was expected since most of joint stock companies in Saudi Arabia did not have remuneration and nomination committees. The rest three Statements (7.22.B.4, 7.22.B.10 and 7.22.B.11) had between 45 to 50 per cent agreement. The Statement 7.22.B.10 that relate to the consultation provided by the board members to their companies was also disagreed upon by the board members themselves as has been shown in Table 7-20. The Statement 7.22.B.11 has almost the same agreement percentage by the chief executive officers (see Table 7-21). Statement 7.22.B.4 with only 48 per cent agreement was relating to the existence of at least three non-executive members in the board of directors.

The statements of the third group (Group 7.22.C) in Table 7-22 represent an evaluation of the audit committee members to themselves and their careers. A look at these statements gives an impression that the participating audit committee members were realistic in their evaluation. In contrast to the evaluation of the board members to themselves in Table 7-20 (Group 7.22.B) where most of the responses of the board members to the statements in Group 7.22.B of Table 7-20 were between 80 to 100 per cent agreement, most of the responses of the audit committee members to the statements in Group 7.22.C in Table 7-22 have fallen between 65 per cent and 75 per cent agreement, 7.22.C.1, 7.22.C.2, 7.22.C.4, 7.22.C.5, 7.22.C.7, 7.22.C.8, 7.22.C.9, 7.22.C.10, 7.22.C.11, 7.22.C.12, 7.22.C.13, 7.22.C.14 and 7.22.C.15. The weakest evaluated statement in Group 7.22.C Table 7-22 was the Statement 7.22.C.6 with only 19 per cent of the audit committee members agreeing, 48 per cent indifferent and 33 per cent disagreeing. This Statement, there are at least four members in the audit committee, also had low agreement percentage by the chief executive officers (33%) as shown in Table 7-21 and low agreement percentage by the board members (32%) as shown in Table 7-20. That is again a clear violation to the Project of Regulating Audit Committees in the Saudi Joint Stock Companies (2003) that have been published by the Saudi Organization for Certified Public Accountants (SOCPA, 2003). The statement 7.22.C.7 (Audit committee includes someone with expertise in accounting and auditing) is also worrying because 22% suggested that the audit committee has no member with accounting or auditing experience.

The final group of statements (Group 7.22.D) in Table 7-22 relates to disclosure and transparency. The responses of the audit committee members to these statements are generally acceptable, however, the responses to the Statement 7.22.D.10 (the company discloses material foreseeable risk factors) was of concern with the lowest agreement percentage, 37%. And again as the Statement 7.22.D.6 (the company discloses the financial and operating results in English) had a low agreement percentage in Table 7-20 by the board members (45%) and not too high agreement percentage in Table 7-21 by the chief executive officers (60%), it also got similar agreement percentage in Table 7-22 by the audit committee members (41%).

7.5.4. Frequencies and Percentages of the Shareholders' Attitudes Toward Each Statement in the Questionnaire

Table 7-23 presents the frequencies and percentages of the responses obtained from shareholders toward each statement in the questionnaire. It should be noted that the number of the respondents from this fourth group (shareholders) is 123. Therefore the total number of the shareholders' responses (#) to each statement (row) must be 123, given that no missing values were involved, and the total of percentages (%) to each statement (row) must be 100 per cent.

Table 7-23 Frequencies and Percentages of the Shareholders' Responses to Each Statement in the Questionnaire

Statement No	Statements	St. Disagree		Disagree		Neither		Agree		St. Agree		Mean
		No	%	No	%	No	%	No	%	No	%	
7.23 .A	**Shareholders Rights:**	#	%	#	%	#	%	#	%	#	%	$\bar{x}$
7.23. A.1	Shareholders have secure methods of ownership registration	-	-	8	6	2	2	63	51	50	41	**4.26**
7.23. A.2	Shareholders are able to practise their rights	-	-	-	-	2	2	54	44	67	54	**4.53**
7.23. A.3	Shareholders obtain timely and regular information on the corporation	12	10	27	22	14	11	70	57	-	-	**3.15**
7.23. A.4	Shareholders understand their rights	-	-	32	26	47	38	34	28	10	8	**3.18**
7.23. A.5	Shareholders care about attending general meetings	13	11	42	34	34	28	30	24	4	3	**2.76**
7.23. A.6	Shareholders are furnished with sufficient and timely information concerning general meetings (date, location and agenda)	6	5	12	10	16	13	59	48	30	24	**3.77**
7.23. A.7	Shareholders participate in the general meeting discussion and ask questions to the board members	4	3	10	8	21	17	62	51	26	21	**3.78**
7.23. A.8	Shareholders vote in general meetings and place items on the agenda	8	6	14	11	29	24	54	44	18	15	**3.49**

7.23. A.9	Shareholders share in the profits of the corporation	-	-	8	6	11	9	66	54	38	31	**4.09**
7.23. A.10	Shareholders elect members of the board	16	13	13	11	30	24	36	29	28	23	**3.38**
7.23. A.11	All shareholders of the same class are treated equally	8	7	11	9	44	36	46	37	14	11	**3.38**
7.23. A.12	Within any class, all shareholders have the same voting rights	6	5	21	17	32	26	42	34	22	18	**3.43**
7.23. A.13	Procedures for general meetings allow for equitable treatment of all shareholders	4	3	12	10	37	30	40	33	30	24	**3.65**
7.23. A.14	Insider trading and abusive self-dealing are prohibited	17	14	12	10	16	13	36	29	42	34	**3.60**
7.23. A.15	Generally, shareholders get their rights	-	-	11	9	24	20	78	63	10	8	**3.71**
	Overall (7.23.A) Mean											**3.61**

7.23 .B	Board of Directors:	#	%	#	%	#	%	#	%	#	%	$\bar{x}$
7.23. B.1	The board of directors monitors the management	-	-	12	10	23	19	68	55	20	16	**3.78**
7.23. B.2	The board members act on a fully informed basis, in good faith, with due diligence and care, and in the best interest of the company and the shareholders	2	2	19	15	12	10	70	57	20	16	**3.71**
7.23. B.3	The board treats all shareholders fairly and equally	10	8	7	6	28	23	50	40	28	23	**3.64**
7.23. B.4	There are at least three non-executive members in the board	-	-	18	15	45	36	50	41	10	8	**3.42**
7.23. B.5	The board ensures compliance with applicable law and take into account the interests of stakeholders	-	-	14	11	21	17	66	54	22	18	**3.78**
7.23. B.6	The board members fulfil their expected key functions including: Reviewing and guiding corporate strategy	2	2	8	6	15	12	82	67	16	13	**3.83**
7.23. B.7	Setting performance objectives	2	2	8	7	19	15	78	63	16	13	**3.80**
7.23. B.8	Overseeing the process of disclosure and communications	-	-	8	7	27	22	72	58	16	13	**3.78**
7.23. B.9	Ensuring the integrity of the corporation's accounting and financial reporting systems	-	-	10	8	25	20	74	60	14	12	**3.75**
7.23. B.10	Board members do not provide consultation to their company and are not affiliated with a company that is an adviser or consultant to the company or senior management	4	3	27	22	48	39	30	24	14	12	**3.19**
7.23. B.11	Board members are not affiliated with a significant customer or supplier	18	15	26	21	37	30	26	21	16	13	**2.97**

7.23. B.12	There is an independent board committee for remuneration	16	13	32	26	43	35	26	21	6	5	**2.79**
7.23. B.13	There is an independent board committee for nomination	20	16	32	26	37	30	28	23	6	5	**2.74**
7.23. B.14	There is an independent board committee for auditing	2	2	12	10	23	18	60	49	26	21	**3.78**
7.23. B.15	The roles of the chief executive officer and the chairman of the board of directors are separated	8	7	21	17	20	16	50	41	24	19	**3.50**
7.23. B.16	The board members devote sufficient time to their responsibilities and attend at least 75% of meetings, on average.	8	6	7	6	28	23	68	55	12	10	**3.56**
7.23. B.17	The firm holds four or more regular board meetings per year	2	2	6	5	29	23	64	52	22	18	**3.80**
7.23. B.18	The board members have access to accurate, relevant and timely information	-	-	-	-	21	17	76	62	26	21	**4.04**
7.23. B.19	Generally, the board of directors is effective	2	2	12	10	27	22	62	50	20	16	**3.70**
	Overall (7.23.B) Mean											**3.56**

7.23 .C	**Audit Committee:**	#	%	#	%	#	%	#	%	#	%	$\bar{x}$
7.23. C.1	Audit committee exists and is independent from management	-	-	9	7	24	20	72	58	18	15	**3.80**
7.23. C.2	The audit committee monitor and review the effectiveness of the company's internal audit function	-	-	11	9	38	31	58	47	16	13	**3.64**
7.23. C.3	The audit committee approves the appointment and replacement of the internal audit head and discusses with him related matters	10	8	30	24	39	32	40	33	4	3	**2.98**
7.23. C.4	The audit committee makes recommendations to the board in relation to the appointment of the external auditor, his remuneration and terms of engagement	2	2	11	9	24	19	64	52	22	18	**3.76**
7.23. C.5	The audit committee reviews and monitors the integrity of the financial statements of the company before they are approved by the board of directors and publicly disseminated to ensure their objectiveness, accuracy, and timeliness	-	-	6	5	27	22	74	60	16	13	**3.81**
7.23. C.6	There are at least four members in the audit committee	5	4	44	36	56	46	14	11	4	3	**2.74**
7.23. C.7	Audit committee includes someone with expertise in accounting and auditing	2	2	17	14	26	21	54	44	24	19	**3.66**

7.23. C.8	The committee members understand the audit committee functions	-	-	11	9	34	27	66	54	12	10	**3.64**
7.23. C.9	Audit committee meets at least four times a year	-	-	7	6	32	26	68	55	16	13	**3.76**
7.23. C.10	Audit committee member attend at least 75% of meetings, on average	-	-	9	7	36	30	58	47	20	16	**3.72**
7.23. C.11	Agenda and related material are provided to members ahead of meetings	-	-	5	4	42	34	62	50	14	12	**3.69**
7.23. C.12	Report on audit committee's activities provided at annual shareholder meeting	-	-	13	11	42	34	66	53	2	2	**3.46**
7.23. C.13	Audit committee has access to relevant information	-	-	10	8	35	29	56	45	22	18	**3.73**
7.23. C.14	Objectives, responsibilities and authority of the audit committee are clearly defined in a written statement (charter)	-	-	6	5	41	33	58	47	18	15	**3.72**
7.23. C.15	Generally, the audit committee is effective	-	-	25	20	28	23	52	42	18	15	**3.51**
	Overall (7.23.C) Mean											**3.57**
7.23 .D	**Disclosure and Transparency:**	#	%	#	%	#	%	#	%	#	%	$\bar{x}$
7.23. D.1	Disclosure and transparency are of high priority in the company	14	11	19	16	20	16	60	49	10	8	**3.27**
7.23. D.2	The company discloses the company's objectives and policies	2	2	14	11	17	14	78	63	12	10	**3.68**
7.23. D.3	The company discloses the financial statements and information in the newspaper	-	-	-	-	4	3	79	64	40	33	**4.29**
7.23. D.4	The company has a website in the Internet	-	-	12	10	29	24	62	50	20	16	**3.73**
7.23. D.5	The company discloses the financial and operating results of the company in Arabic	-	-	8	6	7	6	80	65	28	23	**4.04**
7.23. D.6	The company discloses the financial and operating results of the company in English	-	-	23	19	48	39	48	39	4	3	**3.27**
7.23. D.7	The company discloses major share ownership and voting rights	-	-	16	13	30	24	61	50	16	13	**3.63**
7.23. D.8	The company discloses members of the board and key executives	-	-	9	7	24	20	70	57	20	16	**3.82**
7.23. D.9	The company discloses the remuneration of the board members	18	15	7	6	18	14	60	49	20	16	**3.46**
7.23. D.10	The company discloses material foreseeable risk factors	18	15	19	15	44	36	32	26	10	8	**2.98**
7.23. D.11	The company discloses material issues regarding employees and other stakeholders	8	6	15	12	44	36	44	36	12	10	**3.30**
7.23. D.12	The company discloses governance structures	6	5	16	13	41	33	48	39	12	10	**3.36**

7.23. D.13	The company's information is prepared, audited and disclosed in accordance with the standards of accounting, financial and non-financial disclosure accepted by the Saudi Government	4	3	8	7	21	17	68	55	22	18	**3.78**
7.23. D.14	Channels for disseminating information provide for fair, timely and cost-efficient access to relevant information by users	10	8	17	14	30	24	54	44	12	10	**3.33**
7.23. D.15	Generally, the firm's disclosure and transparency are effective	14	11	17	14	14	11	70	57	8	7	**3.33**
Overall (7.23.D) Mean												**3.55**
Overall (7.23.A, 7.23.B, 7.23.C, 7.23.D) Mean												**3.57**

Do shareholders of Saudi joint stock companies get their expected rights in the shareholders' perspectives? The answer to this very important issue is summarized in Group 7.23.A in Table 7-23. It is really pleasant to know that shareholders in Saudi Arabia have positive perspectives on how they practise their rights and on the way they are treated by Saudi joint stock companies. It could be noticed that at least 62 shareholders (50%) agreed to 12 statements (80%) in the first group, 7.23.A. Ninety eight per cent of the shareholders thought that shareholders are able to practise their rights in Saudi Arabia (Statement 7.23.A.2), ninety two per cent of the shareholders thought that shareholders have secure methods of ownership registration (Statement 7.23.A.1) and eighty five shareholders agreed that shareholders share in the profits of the corporation (Statement 7.23.A.9) (see Table 7-23). In contrast, only twenty seven per cent of the shareholders agreed that shareholders care about attending general meetings (Statement 7.23.A.5) and only thirty six per cent of the shareholders agreed that shareholders understand their rights (Statement 7.23.A.4) (see Table 7-23).

Shareholders also have mostly agreed that the board members (Group 7.23.B in Table 7-23) of the Saudi stock corporations are doing good jobs. At least 80 participating shareholders (65%) agreed to 14 of the statements (74%) in Group 7.23.B. The highest two agreement percentages were given to the Statement 7.23.A.18 (the board members have access to accurate, relevant and timely information), which had about 83 per cent agreement, and the Statement 7.23.A.6 (the board members review and guide corporate strategy), which had about 80 per cent agreement. The Statements 7.23.A.4, 7.23.A.10, 7.23.A.11, 7.23.A.12 and 7.23.A.13 were less agreed upon since the agreement percentages to these statements were 49%, 36%, 34%, 26% and 28%, respectively. The low agreement percentages to the Statements 7.23.A.12 and 7.23.A.13 are not surprising since all of the participating parties (board members, CEOs, etc.) disagreed that there are remuneration and nomination committees in the board of directors. However, the low responses to the Statements 7.23.A.10 and 7.23.A.11 are of much concern since they related to the independence of the board of directors. Finally, less than 50 per cent of the participating shareholders agreed to the Statement 7.23.A.4 that there are at least three non-executive members in the board.

The statements in Group 7.23.C in Table 7-23 were to check how satisfied the shareholders of Saudi joint stock companies are about the ability of the audit committee members to meet the expectations of good corporate governance. Just like the board members, the chief executive officers and the audit committee members who mostly disagreed with the Statement C.6 (see Tables 7-20, 7-21 and 7-22), only 14 per cent of the participating shareholders agreed to this Statement, 7.23.C.6, that there are at least four members in the audit committee (see Table 7-23). The other Statement of concern is 7.23.C.3, the audit committee approves the appointment and replacement of the internal audit head and discusses with him related matters, with only 36 per cent agreement. Recall that this Statement had about 52 per cent of the audit committee members agreeing (see Table 7-22), 46 per cent of the chief executive officers agreeing (see Table 7-21) and only 27 per cent of the board members agreeing (see Table 7-20). The rest of the Statements in this group, Group 7.23.C in Table 7-23, are not of much concern since they had reasonable agreement percentages.

The final set of statements, Group 7.23.D in Table 7-23, related to disclosure and transparency. At least seventy-four shareholders (60%) agreed to 11 Statements in Group 7.23.D, which are 7.23.D.1, 7.23.D.2, 7.23.D.3, 7.23.D.4, 7.23.D.5, 7.23.D.7, 7.23.D.8, 7.23.D.9, 7.23.D.13, 7.23.D.14 and 7.23.D.15, out of 15 statements total in this group. The highest disagreement percentage in this group was the Statement 7.23.D.10, stating that the company discloses material foreseeable risk factors, with only 34 per cent agreement, 30 disagreement and 44 per cent not sure. This Statement was also disagreed with by the audit committee members (see Table 7-22) since only 36 per cent of them agreed that the company discloses the risk factors, however, 74 per cent of the chief executive officers and 64 per cent of the board members agreed (see Tables 7-21 and 7-20). The Statements 7.23.D.6, 7.23.D.11 and 7.23.D.12 also had less than 50 per cent of shareholders agreeing.

7.6. MEASURING DISPERSION

The measures of location or central tendency, which have been discussed in the previous section, were a convenient way of describing a large frequency distribution by means of a single value. Tables 7-20, 7-21, 7-22 and 7-23 in Section 7.5 presented the frequencies and percentages of the responses obtained from the four participating groups – samples – (board members, chief executive officers, audit committee members and shareholders) towards each statement in the questionnaire. However, a simple measure of location on its own does not give any idea of the shape of the data distribution (Collis et al., 2003). Collis and Hussey (2003: 218) stated, "If the measures of location and dispersion are used together, you can obtain a concise and useful description of the distribution of your data set". Dispersion refers to the spread of the values around the central tendency.

Although there are two common measures of dispersion, the range (the highest value minus the lowest value) and the standard deviation (the square root of the variance), the standard deviation is a more accurate and detailed estimate of dispersion because an outlier can greatly exaggerate the range. Collis and Hussey (2003: 222) stated, "The standard deviation is the most important measure of spread because it uses every value and is in the same units as the original data". If σ = standard deviation, $\bar{x}$= mean, **N**= total number of observation and **x** = an observation, then the standard deviation (σ) could be calculated by the following formula:

$$\sigma = \sqrt{\frac{(x_1 - \bar{x})^2 + (x_2 - \bar{x})^2 + \ldots + (x_N - \bar{x})^2}{N}}$$

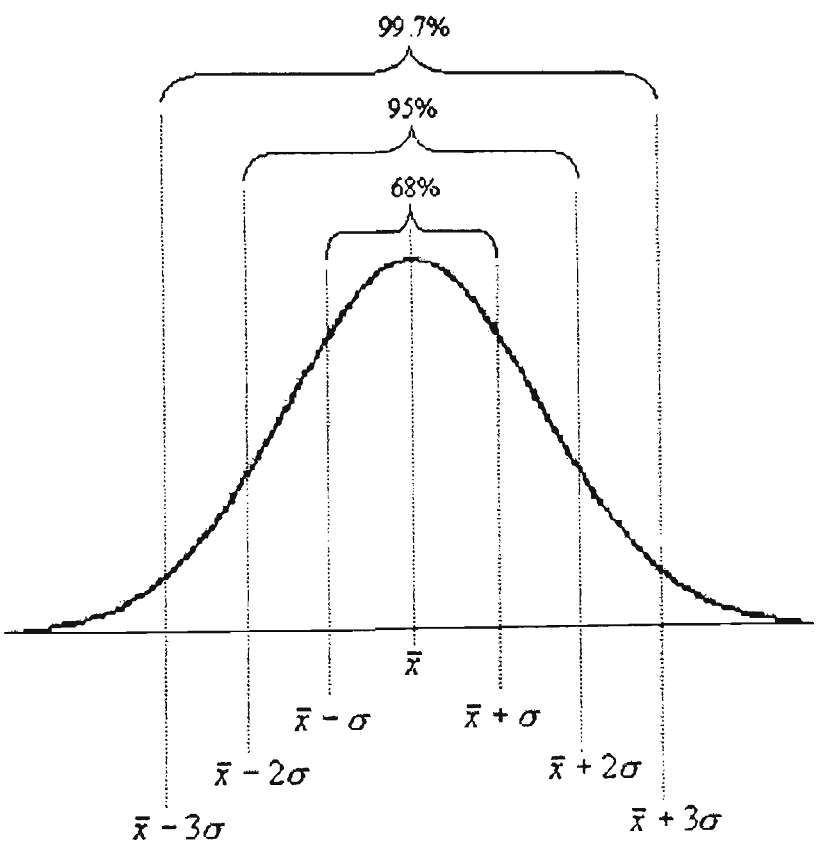
$$= \sqrt{\frac{d_1^2 + d_2^2 + \ldots + d_N^2}{N}}$$

$$= \sqrt{\frac{1}{N}\sum_{i=1}^{N}(x_i - \bar{x})^2} = \sqrt{\frac{1}{N}\sum_{i=1}^{N}d_i^2}$$

7.6.1. Comparison of the Mean Values and Standard Deviations between the Four Samples

Collis and Hussey (2003: 222) stated, "The mean and the standard deviation go together since they both use all the items". When analysing normally distributed data, standard deviation can be used in conjunction with the mean in order to calculate data intervals. Collis and Hussey (2003: 224) stated, "If normality cannot be assumed, a large sample size will ensure that the sampling distribution of the means is approximately normal". If $\bar{x}$= mean, σ = standard deviation and **x** = a value in the data set, then:

- about 68% of the data lie in the interval: $\bar{x} - \sigma < x < \bar{x} + \sigma$.
- about 95% of the data lie in the interval: $\bar{x} - 2\sigma < x < \bar{x} + 2\sigma$.
- about 99% of the data lie in the interval: $\bar{x} - 3\sigma < x < \bar{x} + 3\sigma$.



Therefore, it was found to be a better description to the data if a further table compares the mean values and the standard deviations of the four groups (board members, chief executive officers, audit committee members and shareholders) in one table to be able to measure the spread of data for each statement, each sample and the population. Table 7-24 summarizes the mean values and the standard deviations for the 64 statements of the four samples in the questionnaire to facilitate the comparison among them.

Table 7-24 Comparison of the Mean Values and Standard Deviations for the Statements of the Four Samples

Statement No	Statements	Board of Directors		Chief Executive Officers		Audit Committee Members		Shareholde rs	
		M.	S.D.	M.	S.D.	M.	S.D.	M.	S.D.
7.24 .A	**Shareholders Rights:**	$\bar{x}$	σ	$\bar{x}$	σ	$\bar{x}$	σ	$\bar{x}$	σ
7.24. A.1	Shareholders have secure methods of ownership registration	4.45	.504	4.53	.516	4.07	.908	4.26	.788
7.24. A.2	Shareholders are able to practise their rights	4.59	.497	4.67	.488	4.56	.502	4.53	.533
7.24. A.3	Shareholders obtain timely and regular information on the corporation	3.86	.702	3.93	.704	3.37	1.10	3.15	1.08
7.24. A.4	Shareholders understand their rights	3.32	.934	3.27	.884	3.26	.805	3.18	.915
7.24. A.5	Shareholders care about attending general meetings	3.14	1.11	2.60	1.12	2.93	1.03	2.76	1.04
7.24. A.6	Shareholders are furnished with sufficient and timely information concerning general meetings (date, location and agenda)	4.14	.824	4.60	.507	3.59	1.11	3.77	1.08
7.24. A.7	Shareholders participate in the general meeting discussion and ask questions to the board members	4.18	.843	4.40	.632	3.74	.975	3.78	.980
7.24. A.8	Shareholders vote in general meetings and place items on the agenda	4.23	.743	4.27	.704	3.52	1.15	3.49	1.08
7.24. A.9	Shareholders share in the profits of the corporation	4.36	.718	4.33	.724	4.11	.883	4.09	.810
7.24. A.10	Shareholders elect members of the board	4.05	.939	4.13	.990	3.37	1.32	3.38	1.30
7.24. A.11	All shareholders of the same class are treated equally	3.86	.824	4.27	.704	3.52	.926	3.38	1.02
7.24. A.12	Within any class, all shareholders have the same voting rights	3.77	.961	4.20	.862	3.37	1.10	3.43	1.01 2
7.24. A.13	Procedures for general meetings allow for equitable treatment of all shareholders	4.27	.624	4.47	.516	3.67	.991	3.65	1.06
7.24. A.14	Insider trading and abusive self-dealing are prohibited	4.00	1.14	4.00	1.20	3.89	1.27	3.60	1.40
7.24. A.15	Generally, shareholders get their rights	4.18	.495	4.00	.535	3.56	.793	3.71	.744
Overall M. & S.D. (Group 7.24.A)		**4.02**	**.523**	**4.11**	**.427**	**3.64**	**.620**	**3.61**	**.647**

No.	Item		$\bar{x}$	σ	$\bar{x}$	σ	$\bar{x}$	σ	$\bar{x}$	σ
7.24 .B	**Board of Directors:**		$\bar{x}$	σ	$\bar{x}$	σ	$\bar{x}$	σ	$\bar{x}$	σ
7.24. B.1	The board of directors monitors the management		4.00	.863	4.27	.594	4.04	.846	3.78	.835
7.24. B.2	The board members act on a fully informed basis, in good faith, with due diligence and care, and in the best interest of the company and the shareholders		4.23	.424	3.93	.799	3.74	1.12	3.71	.973
7.24. B.3	The board treats all shareholders fairly and equally		4.32	.639	4.13	.743	3.74	1.22	3.64	1.14
7.24. B.4	There are at least three non-executive members in the board		3.82	.896	3.93	.961	3.41	.836	3.42	.840
7.24. B.5	The board ensures compliance with applicable law and take into account the interests of stakeholders		4.32	.561	4.00	.535	3.81	.913	3.78	.873
7.24. B.6	The board members fulfil their expected key functions including	Reviewing and guiding corporate strategy	4.09	4.13	4.13	.640	3.85	.856	3.83	.797
7.24. B.7		Setting performance objectives	4.14	4.20	4.20	.561	3.78	.883	3.80	.809
7.24. B.8		Overseeing the process of disclosure and communications	4.05	4.13	4.13	.640	3.78	.744	3.78	.752
7.24. B.9		Ensuring the integrity of the corporation's accounting and financial reporting systems	4.18	4.20	4.20	.676	3.70	.816	3.75	.764
7.24. B.10	Board members do not provide consultation to their company and are not affiliated with a company that is an adviser or consultant to the company or senior management		4.45	1.17	3.53	.834	3.41	1.14	3.19	1.01
7.24. B.11	Board members are not affiliated with a significant customer or supplier		3.68	1.20	3.33	1.05	3.11	1.46	2.97	1.24
7.24. B.12	There is an independent board committee for remuneration		2.91	1.18	2.93	1.44	2.85	1.05	2.79	1.07
7.24. B.13	There is an independent board committee for nomination		2.91	1.18	2.73	1.28	2.74	1.19	2.74	1.13
7.24. B.14	There is an independent board committee for auditing		4.14	.632	4.27	.884	3.81	1.03	3.78	.946
7.24. B.15	The roles of the chief executive officer and the chairman of the board of directors are separated		3.77	1.10	3.87	.990	3.59	1.41	3.50	1.18
7.24. B.16	The board members devote sufficient time to their responsibilities and attend at least 75% of meetings, on average.		4.27	.451	4.07	.258	3.52	1.01	3.56	.976
7.24. B.17	The firm holds four or more regular board meetings per year		4.32	.561	4.27	.884	3.93	.669	3.80	.849
7.24. B.18	The board members have access to accurate, relevant and timely information		4.27	.544	4.47	.516	4.19	.552	4.04	.619
7.24. B.19	Generally, the board of directors is effective		4.32	.471	4.13	.516	3.74	.975	3.70	.914
	Overall M. & S.D. (Group 7.24.B)		**4.01**	**.395**	**3.92**	**.428**	**3.62**	**.562**	**3.56**	**.527**
7.24 .C	**Audit Committee Members:**		$\bar{x}$	σ	$\bar{x}$	σ	$\bar{x}$	σ	$\bar{x}$	σ

7.24. C.1	Audit committee exists and is independent from management	4.09	.520	4.20	.561	3.78	.883	3.80	.775
7.24. C.2	The audit committee monitor and review the effectiveness of the company's internal audit function	3.59	.488	3.93	.704	3.70	.903	3.64	.821
7.24. C.3	The audit committee approves the appointment and replacement of the internal audit head and discusses with him related matters	2.86	.878	3.27	.884	3.15	1.19	2.98	1.02
7.24. C.4	The audit committee makes recommendations to the board in relation to the appointment of the external auditor, his remuneration and terms of engagement	4.14	.702	4.27	.704	3.74	.894	3.76	.908
7.24. C.5	The audit committee reviews and monitors the integrity of the financial statements of the company before they are approved by the board of directors and publicly disseminated to ensure their objectiveness, accuracy, and timeliness	4.05	.645	3.87	.915	3.85	.711	3.81	.717
7.24. C.6	There are at least four members in the audit committee	3.05	1.03	2.93	1.22	2.89	.793	2.74	.838
7.24. C.7	Audit committee includes someone with expertise in accounting and auditing	3.95	.714	4.00	.845	3.67	1.20	3.66	.999
7.24. C.8	The committee members understand the audit committee functions	3.95	.645	4.00	.756	3.74	.757	3.64	.780
7.24. C.9	Audit committee meets at least four times a year	4.05	.645	4.00	1.00	3.85	.656	3.76	.750
7.24. C.10	Audit committee member attend at least 75% of meetings, on average	4.09	.603	4.27	.704	3.78	.883	3.72	.823
7.24. C.11	Agenda and related material are provided to members ahead of meetings	4.05	.645	3.93	.594	3.81	.779	3.69	.726
7.24. C.12	Report on audit committee's activities provided at annual shareholder meeting	3.50	.792	3.13	.834	3.78	.502	3.46	.705
7.24. C.13	Audit committee has access to relevant information	3.95	.714	3.87	.743	3.85	.899	3.73	.850
7.24. C.14	Objectives, responsibilities and authority of the audit committee are clearly defined in a written statement (charter)	3.91	.541	3.93	.458	3.85	.899	3.72	.774
7.24. C.15	Generally, the audit committee is effective	3.95	.569	3.87	.915	3.67	1.06	3.51	.978
Overall M. & S.D. (Group 7.24.C)		**3.81**	**.464**	**3.83**	**.457**	**3.67**	**.580**	**3.57**	**.521**
7.24 .D	**Disclosure and Transparency:**	$\bar{x}$	σ	$\bar{x}$	σ	$\bar{x}$	σ	$\bar{x}$	σ
7.24. D.1	Disclosure and transparency are of high priority in the company	3.95	.714	4.13	.516	3.44	1.04	3.27	1.17
7.24. D.2	The company discloses the company's objectives and policies	4.14	.554	4.07	.704	3.89	.744	3.68	.862
7.24. D.3	The company discloses the financial statements and information in the newspaper	4.36	.650	4.53	.516	4.22	.572	4.29	.524
7.24. D.4	The company has a website in the Internet	3.95	.888	4.13	.834	3.89	.744	3.73	.850

7.24. D.5	The company discloses the financial and operating results of the company in Arabic	4.23	.605	4.27	.799	4.04	.643	4.04	.740
7.24. D.6	The company discloses the financial and operating results of the company in English	3.27	.872	3.40	.986	3.22	.839	3.27	.800
7.24. D.7	The company discloses major share ownership and voting rights	4.14	.702	4.07	.594	3.59	.880	3.63	.872
7.24. D.8	The company discloses members of the board and key executives	4.18	.657	4.13	.516	3.85	.656	3.82	.790
7.24. D.9	The company discloses the remuneration of the board members	4.09	.603	4.33	.617	3.48	1.15	3.46	1.26
7.24. D.10	The company discloses material foreseeable risk factors	3.82	.843	3.73	.884	3.07	1.03	2.98	1.16
7.24. D.11	The company discloses material issues regarding employees and other stakeholders	3.77	.859	3.80	.676	3.44	.883	3.30	1.02
7.24. D.12	The company discloses governance structures	3.82	.724	4.13	.743	3.37	.958	3.36	.993
7.24. D.13	The company's information is prepared, audited and disclosed in accordance with the standards of accounting, financial and non-financial disclosure accepted by the Saudi Government	4.05	.645	4.47	.516	3.74	1.01	3.78	.928
7.24. D.14	Channels for disseminating information provide for fair, timely and cost-efficient access to relevant information by users	3.77	.803	4.20	.676	3.44	.925	3.33	1.09
7.24. D.15	Generally, the firm's disclosure and transparency are effective	4.09	.603	4.13	.640	3.44	1.04	3.33	1.15
Overall M. & S.D. (Group 7.24.D)		**3.98**	**.521**	**4.10**	**.417**	**3.61**	**.588**	**3.55**	**.701**
Overall M. & S.D. (Groups 7.24.A, 7.24.B, 7.24.C, 7.24.D)		**3.95**	**.378**	**3.99**	**.330**	**3.64**	**.488**	**3.57**	**.531**

Generally, the more widely spread the values are, the larger the standard deviation is. Standard deviation is useful when comparing the spread of two separate data sets that have approximately the same mean. The data set with the smaller standard deviation has a narrower spread of measurements around the mean and therefore usually has comparatively fewer high or low values. An item selected at random from a data set whose standard deviation is low has a better chance of being close to the mean than an item from a data set whose standard deviation is higher.

Starting with the first set of statements, Group 7.24.A, in Table 7-24 that is related to the rights of the shareholders, it could be seen that the overall mean values for the four samples (board of directors' members, chief executive officers (CEOs), audit committee members and shareholders) were 4.02, 4.11, 3.64 and 3.61,respectively, and the standard deviation values were .523, .427, .620 and .647, respectively. Obviously, the agreements obtained from the first two samples (the board members and the chief executive officers) were higher than the agreements obtained from the audit committee members and the shareholders. Comparing the standard deviations of the first two samples that have almost the same mean indicates that these two samples are narrow since their standard deviations are small; the same could be said for the other two samples (audit committee members and the shareholders). However, it could be noticed that the last two samples are more spread than the first two. The narrowness of the standard deviations of the first two samples means that the board members and the chief executive officers think that shareholders get their expected right. Because the mean values of these two samples were relatively higher than the second two samples (audit members and shareholders) and the standard deviations are also narrower, it could be concluded that board members and the CEOs were more confident that shareholders are exercising their rights and this element of corporate governance is effective.

Group 7.24.B in Table 7-24 that contains statements relating to the effectiveness of the board of directors seems to be very much the same as the overall responses to the first group, 7.24.A. The only difference that could be noticed from the Table is the responses obtained from the second sample, chief executive officers, since they were less confident about the effectiveness of the board of directors – Group 7.24.B – than they were with the shareholders rights – Group 7.24.A. The overall mean of the chief executive officers' responses to the statements of the effectiveness of board of directors was 3.92 and the standard deviation was .428, whereas the mean of their responses to the first group, shareholders rights, was 4.11 and the standard deviation was .427. Adams and Ferreira (2003) analysed the consequences of the board of directors' dual role as an advisor and a monitor of management. This dual role as well as the agency problems may effect the management's evaluation to the board of directors.

The statements relating to the effectiveness of the audit committees, Group 7.24.C, in Table 7-24 seems to differ, especially in the dispersion point of view. The mean values, however, are mostly the same as the first two groups except for the first sample, board of directors, since the mean of the responses obtained from this sample was less for this group, 7.24.C. That indicates that the board members were more concerned about the effectiveness of the audit committees in Saudi Arabia than they were with their evaluation to the effectiveness of the board members and the shareholders' rights. The dispersion, on the other hand, seems to be narrower in this group, 7.24.C, giving the impression that all the participating groups had more closer opinions towards these statements.

The final set of statements, Group 7.24.D, in Table 7-24 relates to the disclosure and transparency. The board members and the chief executive officers are more confident as to the effectiveness of the disclosure and transparency in Saudi joint stock companies than the audit committee members and the shareholders. The shareholders were the least in the mean values in regards of the disclosure and transparency. There is no doubt that the disclosure of accurate and comprehensive information about corporate performance is a key to promote shareholders confidence and market efficiency. Provided with sufficient and timely information, investors incur lower cost in evaluating investment alternatives and monitoring the performance of companies in their portfolios. Although the agreement of the shareholders towards the statements in Group 7.24.D was not too bad, attention should be given to enhance the confidence of the shareholders regarding the effectiveness of the disclosure and transparency.

7.7. SUMMARY

The main objective of this part of the study was to examine the effectiveness of corporate governance in Saudi joint stock companies. Four groups – samples – were selected to respond to a survey questionnaire in order to examine their attitudes towards the effectiveness of corporate governance in Saudi Arabia. The subject groups were (i) the board of directors' members, (ii) the chief executive officers, (iii) the audit committee members and (iv) individual shareholders.

A total of 236 questionnaires were received back from the four samples: 44 board of directors' members, 15 chief executive officers, 54 audit committee members and 123 individual shareholders. Data was analysed using the Statistical Package for Social Science studies, SPSS, version 12. Where applicable, descriptive statistics (frequencies, percentages, cross-tabulation, central tendency and dispersion) were used in analysing and presenting the results.

The results of demographic part of the analysis in this chapter revealed that most of the participants were educationally qualified in the sense that the majority of the participants, at least 225 (95%), had a bachelors' degree or more and about 60 per cent of the participants had more than 15 years in their current jobs. The results also indicated that about 46 per cent of the board members, 60 per cent of the chief executive officers and 56 per cent of the audit committee members specialized in business.

With respect to the central tendency and the dispersion, the respondents' agreement on the items presented in the questionnaire was reflected in the high mean and median scores as well as the low values of the standard deviation calculated. Despite the agreement in opinion between the respondents, there were some significant differences on certain items in the questionnaire. However, the differences were likely to be in the degree of emphasis among the selected groups and mostly within the agreement level.

Analyses of the collected data support, in general, most of the items presented in the questionnaire. Most of the participants agreed that corporate governance of joint stock companies in Saudi Arabia was generally effective.

Therefore, it could be finally concluded that the results of this part of the analysis reveal that most of the respondents considered corporate governance as of most importance in governing and guiding their companies. Although corporate governance is still in the developing stage in Saudi Arabia, it seems that the key players of corporate governance – board of directors' members, chief executive officers, audit committee members and shareholders – in Saudi joint stock companies are relatively confident about the effectiveness of corporate governance in Saudi Arabia. However, the need for corporate governance improvements and reforms is absolutely of high priority.

CHAPTER EIGHT:

QUANTITATIVE DATA ANALYSIS II:

INFERENTIAL STATISTICS

8.1. INTRODUCTION

The exploratory (descriptive) data analysis discussed in the previous chapter was concerned with summarizing and presenting the data in tables, charts and other diagrammatic forms that enable patterns and relationships to be discerned which are not apparent in the raw data. Descriptive statistics such as frequency, cross-tabulation, mean, median, mode, variance and standard deviation were carried out to assess the effectiveness of the four elements of corporate governance discussed in the fourth and fifth chapters of this thesis, namely: shareholders' rights; board of directors; audit committees; and disclosure and transparency.

The confirmatory (inferential) data analysis, however, goes beyond mere description of the data and arrives at inferences regarding the phenomena for which the sample data were obtained (Weiers, 2005). Examples involve some more complex analyses like t-tests, regression/correlation and ANOVA.

Setting up and testing the hypotheses is an essential part of the inferential statistics. In order to formulate such a test, a theory has been developed in the previous chapters, either because it is believed to be true or because it is to be used as a basis for argument but has not been proved.

Hypothesis testing tests one or more sample populations for a statistical characteristic or interaction. The results of the testing process are generally used to formulate conclusions about the probability distributions of the sample populations. Weiers (2005:362) stated,

> "In statistics, as in life, nothing is as certain as the presence of uncertainty. However, just because we are not 100% sure of something, that is no reason why we can't reach some conclusions that are highly likely to be true".

Nester (1996) suggested several reasons why hypothesis tests are widely used: (1) hypothesis tests appear to be objective and exact; (2) they are readily available and easily invoked in many commercial statistics packages; (3) everyone else seems to use them; (4) students, statisticians, and scientists are taught to use them; and (5) some journal editors and thesis supervisors demand them. Carver (1978) recognized that statistical significance is generally interpreted as having some relationship to replication, which is the cornerstone of science. Rejection of a statistical hypothesis would constitute a piece of evidence to be considered in deciding whether or not to reject a scientific hypothesis (Simberloff 1990).

The rest of this chapter will be handled by using a variety of statistical tools to analyse data and, ultimately, to fail to reject or to reject the null hypotheses. The next section, testing the hypotheses, will be focusing on using statistical analysis to determine if the observed differences between the four samples are due to random chance (as stated in the null hypotheses) or to true differences in the samples (as stated in the alternate hypotheses).

8.2. TESTING THE HYPOTHESES

After collecting the four groups of scores in the current study, the researcher noticed that the scores (and their means) differ to some extent. Some differences occur simply because of chance. When looking at the four group samples – board of directors, chief executive officers, audit committee members and shareholders – the researcher was faced with the problem of whether the observed differences were merely due to chance or not. Saying that one mean of one sample, e.g., board of directors, was larger than another mean of another sample, e.g., chief executive officers, was just not enough evidence that a real difference exists between the two larger populations. The procedures of statistical inference enable the researcher to determine, in terms of probability, whether the observed difference was within the range which could easily occur by chance or whether it was so large that it signified that the two samples were indeed probably from two different populations with real differences in characteristics.

In traditional significance testing, it is not the experimental hypothesis that is directly tested but its negation, which is known as the null hypothesis (H_o) of no relationship between the two variables being examined (Weiers, 2005; Kiess, 1996).

Several steps associated with formulating and testing the hypotheses (Weiers, 2005; Kiess, 1996; and Collis et al., 2003) will be used in this study. These could be summarized into five main steps.

1. Formulate the null (H_o) and alternative (H_1) hypotheses.
2. Specify the significance level.
3. Select an appropriate statistical test.
4. Identify the probability distribution of the test statistic and define the region of rejection.
5. Compute the value of the test statistic from the data and decide whether to accept or reject the null hypothesis.

8.2.1. Formulating the Null (H_o) and Alternative (H_1) Hypotheses

As it has been clarified in Chapter 5 that one of the first steps in the hypotheses testing procedure is to state the null and alternative hypotheses. The null hypothesis is a hypothesis of no differences, i.e., the null hypothesis in the current study is that there is no significant difference in the mean values between the four groups, namely: board of directors; chief executive officers; audit committee members; and shareholders (e.g., H_o: $\mu_{board} = \mu_{ceo} = \mu_{audit} = \mu_{share}$). The actual hypothesis that the researcher is interested in, however, is the alternative hypothesis (e.g., H_1: $\mu_{board} \neq \mu_{ceo} \neq \mu_{audit} \neq \mu_{share}$) if the null hypothesis fails, i.e., that there probably is a real difference. Statistics cannot prove there is a difference between two groups. The best that it can do is to tell that an observed difference between samples is substantially different (i.e., significantly different) from what would be expected by chance if the samples came from four groups which were the same (or had the same characteristics).

8.2.1.1. The Null and Alternative Hypotheses of the First Group: Shareholders' Rights

H_0 (1): Differences observed in the mean scales of the four categories of participants (board of directors' members, chief executive officers, audit committee members and shareholders) – with respect to the shareholders' rights – are statistically insignificant in Saudi joint stock corporations.

H_1 (1): Differences observed in the mean scales of the four categories of participants (board of directors' members, chief executive officers, audit committee members and shareholders) – with respect to the shareholders' rights – are statistically significant in Saudi joint stock corporations.

This hypothesis is statistically formulated as follows.

$H_{0\,SHR}: \mu_{board} = \mu_{ceo} = \mu_{audit} = \mu_{share}$ $\quad$ $H_{1\,SHR}: \mu_{board} \neq \mu_{ceo} \neq \mu_{audit} \neq \mu_{share}$

Note	μ_{board}	Mean of sample1 (board of directors)
	μ_{ceo}	Mean of sample2 (chief executive officers, CEO)
	μ_{audit}	Mean of sample3 (audit committee members)
	μ_{share}	Mean of sample4 (shareholders)
	$H_{0\,SHR}$	Null hypothesis in respect to shareholders rights
	$H_{1\,SHR}$	Alternative hypothesis in respect to shareholders rights

8.2.1.2. The Null and Alternative Hypotheses of the Second Group: Board of Directors

H_0 (2): Differences observed in the mean scales of the four categories of participants (board of directors' members, chief executive officers, audit committee members and shareholders) – with respect to the board of directors – are statistically insignificant in Saudi joint stock corporations.

H_1 (2): Differences observed in the mean scales of the four categories of participants (board of directors' members, chief executive officers, audit committee members and shareholders) – with respect to the board of directors – are statistically significant in Saudi joint stock corporations.

This hypothesis is statistically formulated as follows.

H_0 BD: $\mu_{board} = \mu_{ceo} = \mu_{audit} = \mu_{share}$ H_1 BD: $\mu_{board} \neq \mu_{ceo} \neq \mu_{audit} \neq \mu_{share}$

Note	μ_{board}	Mean of sample1 (board of directors)
	μ_{ceo}	Mean of sample2 (chief executive officers, CEO)
	μ_{audit}	Mean of sample3 (audit committee members)
	μ_{share}	Mean of sample4 (shareholders)
	$H_{o\ BD}$	Null hypothesis in respect to board of directors
	$H_{1\ BD}$	Alternative hypothesis in respect to board of directors

8.2.1.3. The Null and Alternative Hypotheses of the Third Group: Audit Committee and Internal Audit

H_o (3): Differences observed in the mean scales of the four categories of participants (board of directors' members, chief executive officers, audit committee members and shareholders) – with respect to the audit committees – are statistically insignificant in Saudi joint stock corporations.

H_1 (3): Differences observed in the mean scales of the four categories of participants (board of directors' members, chief executive officers, audit committee members and shareholders) – with respect to the audit committees – are statistically significant in Saudi joint stock corporations.

This hypothesis is statistically formulated as follows.

H_o AC: $\mu_{board} = \mu_{ceo} = \mu_{audit} = \mu_{share}$ H_1 AC: $\mu_{board} \neq \mu_{ceo} \neq \mu_{audit} \neq \mu_{share}$

Note	μ_{board}	Mean of sample1 (board of directors)
	μ_{ceo}	Mean of sample2 (chief executive officers, CEO)
	μ_{audit}	Mean of sample3 (audit committee members)
	μ_{share}	Mean of sample4 (shareholders)
	$H_{o\ AC}$	Null hypothesis in respect to Audit Committees and Internal Audit
	$H_{1\ AC}$	Alternative hypothesis in respect to Audit Committees and Internal Audit

8.2.1.4. The Null and Alternative Hypotheses of the Fourth Group: Disclosure and Transparency

H_0 (4): Differences observed in the mean scales of the four categories of participants (board of directors' members, chief executive officers, audit committee members and shareholders) – with respect to the disclosure and transparency – are statistically insignificant in Saudi joint stock corporations.

H_1 (4): Differences observed in the mean scales of the four categories of participants (board of directors' members, chief executive officers, audit committee members and shareholders) – with respect to the disclosure and transparency – are statistically significant in Saudi joint stock corporations.

This hypothesis is statistically formulated as follows.

$H_{0\ D\&T}$: $\mu_{board} = \mu_{ceo} = \mu_{audit} = \mu_{share}$ $\quad$ $H_{1\ D\&T}$: $\mu_{board} \neq \mu_{ceo} \neq \mu_{audit} \neq \mu_{share}$

Note		
	μ_{board}	Mean of sample1 (board of directors)
	μ_{ceo}	Mean of sample2 (chief executive officers, CEO)
	μ_{audit}	Mean of sample3 (audit committee members)
	μ_{share}	Mean of sample4 (shareholders)
	$H_{0\ D\&T}$	Null hypothesis in respect to disclosure and transparency
	$H_{1\ D\&T}$	Alternative hypothesis in respect to disclosure and transparency

8.2.2. Specifying the Significance Level

The researcher must choose the point at which the probability of observing such a big difference between two groups by chance is so low that the researcher can reasonably reject the null hypothesis of no difference and conclude that there probably is a real difference. The point chosen is called the significance, probability or alpha level (α), usually at 5% or 1% (Weiers, 2005); the standard 5% significance level will be used in the current study. This means that such a large observed difference between the groups with the same characteristics would occur only 5% of the time by chance when the null hypothesis is true. This also means that except for a 5% chance of being wrong the researcher can reasonably reject the hypothesis that the two groups are the same. The null hypothesis is assumed to be true unless the data cause the researcher to reject it.

If we end up rejecting the null hypothesis, there is a chance of reaching a wrong conclusion – i.e., Type I error. The significance level is the probability that the researcher will make such a mistake. There are two different types of errors that can be made. Table 8-1 outlines the possible correct and incorrect decisions in hypothesis testing.

Table 8-1 Type I and Type II Errors

Statistical Decision for the Null Hypothesis	Reality: The Null Hypothesis Is	
	True	False
Accept	Correct Decision	Incorrect Decision (Type II error)
Reject	Incorrect Decision (Type I error)	Correct Decision

The null hypothesis being tested may be either true or false. We may reject the null hypothesis when it is, in fact, true. This is referred to as a Type I error. It occurs when we think there is a difference between our groups, where there is really none. We can minimise this possibility by selecting an appropriate alpha level. The second type of error that can be made is called Type II error. This occurs when we fail to reject a null hypothesis when it is, in fact, false (that is, believing that the groups do not differ, when in fact they do). These two errors are inversely related. As we try to control for a Type I error, we actually increase the likelihood that we will commit a Type II error (Kiess, 1996).

8.2.3. Selecting an Appropriate Statistical Test

The selection of an appropriate statistical test is the most difficult and frustrating step in hypothesis testing. Tests of hypothesis can be carried out on one, two or more than two samples.

The researcher is attempting to examine the significance of the differences in the mean values between the mean value of each of the four samples (board members, chief executive officers, audit committee members and shareholders) with respect to each group of statements in the questionnaire (shareholders' rights, board of directors, audit committee and internal audit and disclosure and transparency). The researcher, therefore, is interested in examining the following hypothesis: H_0: $\mu_{board} = \mu_{ceo} = \mu_{audit} = \mu_{share}$, where ($\mu_{board}$) is the first sample's mean value (board of directors), (μ_{ceo}) is the second sample's mean value (chief executive officers), (μ_{audit}) is the third sample's mean value (audit committee members) and (μ_{share}) is the fourth sample's mean value (shareholders). The Analysis of Variance (ANOVA) test was thought to be the best statistical test in the current study since it is used to compare the means when more than two samples are involved. The ANOVA test is just like the t-test (used when only one or two samples are involved (Kiess, 1996)), however, it imposes no restriction on the number of samples.

8.2.4. Defining the Region of Rejection

The probability value (p-value) of a statistical hypothesis test (t, F, etc.) is the probability of getting a value of the test statistic as extreme as or more extreme than that observed by chance alone, if the null hypothesis H_0 is true. It is the probability of wrongly rejecting the null hypothesis if it is in fact true.

Should the p-value be small, this is taken as evidence against the H_0, because a value that extreme is unlikely (though possible) under H_0. H_0 is rejected if the p-value is less than a small criterion probability known as the significance level (Weiers, 2005). Small p-values suggest that the null hypothesis is unlikely to be true. The smaller it is, the more convincing the evidence is that null hypothesis is false.

The probability value is usually set at a probability or p level of 0.05. When the p-value of a statistic is less than the significance level, the value of the statistic is said to be significant. The conventional probability or p-value for deciding that a result is not due to chance has been set as equal to or less than 0.05. If we are willing to accept a 5% chance of making an error, we can construct a 95% confidence interval (Weisberg et al, 1996; Kiess, 1996). If the probability is less than 0.05, then it is thought unlikely to have been due to chance. If, on the other hand, the probability level of an outcome is above 0.05, then that result is statistical non-significant in the sense that it is considered likely that it could have been due to chance (Weiers, 2005). In other words, the p-value is the probability that the null hypothesis is true. If the p-value is less than 0.05, we would say the result is significant at the 0.05 level (Weisberg et al, 1996).

If the p-value is larger than the significance level, H_0 is accepted. This does not mean that it is actually true: it only means that the evidence is insufficient to justify a rejection. To sum up (Kinnear and Gray, 2004) posit the following (Table 8-2).

Table 8-2 Region of Rejection (Kinnear and Gray, 2004)

IF P-VALUE	Greater than 0.05	H_0 is accepted and the result is not significant
	Equal or less than 0.05 but greater than 0.01	H_0 is rejected and the result is significant beyond the 5 per cent level
	Less than 0.01	H_0 is rejected and the result is significant beyond the 1 per cent level

Either rejecting or failing to reject the null hypotheses is dependent on the location of the observed F-value relative to the critical 'F' values (Appendix 2). Depending on the calculated or observed F-value, it will fall into either a rejection region or non-rejection region. If the calculated or observed F-value is in the rejection region, the null hypothesis will be rejected. Otherwise, the null hypothesis cannot be rejected. Failure to reject the null hypothesis does not confirm that it is true, but rather that we are unable to reject it at the level of significance being used.

8.2.5. Computing the Value of the Test Statistic from the Data and Deciding Whether to Accept or Reject the Null Hypotheses

8.2.5.1. Analysis of Variance (ANOVA) Tests

The analysis of variance (ANOVA) performs comparisons like the t-test, but for a number of factors. Howell (2002: 299) stated:

> First, the analysis of variance, like t, deals with differences between or among sample means; unlike t, it imposes no restriction on the number of means. Instead of asking whether two means differ, we can ask whether three, four, five, or k means differ. The analysis of variance also allows us to deal with two or more independent variables simultaneously, asking not only about the individual effects of each variable separately but also about the interacting effects of two or more variables.

The analysis of variance (ANOVA) is a technique that resolves the shortcomings of the t-test. It examines the means of sub-groups in the sample and analyses the variances as well (Babbie et al., 2003). It has the distinct advantage of being applicable when more than two means are being compared (Churchill and Iacobucci, 2002).

It should be remembered that the author, in this chapter, is testing the null hypotheses that the differences observed in the mean scales of the four categories of participants (the board of directors' members, the chief executive officers, the audit committee members and the shareholders) – with respect to the four mechanisms of corporate governance (shareholders' rights, board of directors, audit committee and internal audit and disclosure and transparency) – are statistically insignificant in Saudi joint stock corporations.

The ANOVA tests are conducted in this section to test the significance of the differences in the mean values between the four samples themselves. The following hypotheses are tested in this section (Table 8-3).

Table 8-3 Statistical formulation of the hypotheses tested in the current thesis

Null Hypotheses	**Alternative Hypotheses**
$H_{0\,SHR}$: $\mu_{board} = \mu_{ceo} = \mu_{audit} = \mu_{share}$	$H_{1\,SHR}$: $\mu_{board} \neq \mu_{ceo} \neq \mu_{audit} \neq \mu_{share}$
$H_{0\,BD}$: $\mu_{board} = \mu_{ceo} = \mu_{audit} = \mu_{share}$	$H_{1\,BD}$: $\mu_{board} \neq \mu_{ceo} \neq \mu_{audit} \neq \mu_{share}$
$H_{0\,AC}$: $\mu_{board} = \mu_{ceo} = \mu_{audit} = \mu_{share}$	$H_{1\,AC}$: $\mu_{board} \neq \mu_{ceo} \neq \mu_{audit} \neq \mu_{share}$
$H_{0\,D\&T}$: $\mu_{board} = \mu_{ceo} = \mu_{audit} = \mu_{share}$	$H_{1\,D\&T}$: $\mu_{board} \neq \mu_{ceo} \neq \mu_{audit} \neq \mu_{share}$

Note	μ_{board}	Mean of sample1 (board of directors)
	μ_{ceo}	Mean of sample2 (chief executive officers, CEO)
	μ_{audit}	Mean of sample3 (audit committee members)
	μ_{share}	Mean of sample4 (shareholders)
	$H_{0\,SHR}$	Null hypothesis in respect to shareholders rights
	$H_{1\,SHR}$	Alternative hypothesis in respect to shareholders rights
	$H_{0\,BD}$	Null hypothesis in respect to board of directors
	$H_{1\,BD}$	Alternative hypothesis in respect to board of directors
	$H_{0\,AC}$	Null hypothesis in respect to Audit Committees and Internal Audit
	$H_{1\,AC}$	Alternative hypothesis in respect to Audit Committees and Internal Audit
	$H_{0\,D\&T}$	Null hypothesis in respect to disclosure and transparency
	$H_{1\,D\&T}$	Alternative hypothesis in respect to disclosure and transparency

Table 8-4 presents the results of the analysis of variance (ANOVA) for the four samples (board of directors, chief executive officers, audit committee members and shareholders) with respect to each of the four mechanisms of corporate governance (shareholders' rights, board of directors, audit committee and internal audit and disclosure and transparency).

The observed F-value of Group 8.4.A in Table 8-4, 7.49, is obviously greater than the critical F-value of 2.60 (Table 8-4). Also the P-value of this group of 0.000 is significant. Therefore, the null hypothesis – that the differences observed in the mean scales of the participants (the board of directors' members, the chief executive officers, the audit committee members and the shareholders) with respect to the first mechanism of corporate governance, shareholders' rights, are statistically insignificant in Saudi joint stock corporations ($H_{o\ SHR}$: $\mu_{board} = \mu_{ceo} = \mu_{audit} = \mu_{share}$) – is rejected. The rejection of this hypothesis means that the differences in the mean values between the samples are statistically significant. In different words, the participants had different perspectives towards the effectiveness of the first mechanism of corporate governance, shareholders' rights, in Saudi joint stock corporations.

The observed F-value of Group 8.4.B, 8.21, is also greater than the critical F-value, so it falls in the rejection region, and the p-value of 0.000 is significant. The null hypothesis of no significant difference between the four samples with respect to the second mechanism of corporate governance, board of directors, ($H_{o\ BD}$: $\mu_{board} = \mu_{ceo} = \mu_{audit} = \mu_{share}$) is also rejected. The third Group, 8.4.C, in Table 8-4 is slightly different from the rest of the groups since the p-value of 0.037 is the highest amongst the four groups. Therefore, the null hypothesis that there is insignificant difference in the mean scales of the four samples with respect to the third mechanism of corporate governance, audit committee and internal audit, ($H_{o\ AC}$: $\mu_{board} = \mu_{ceo} = \mu_{audit} = \mu_{share}$) is not rejected at the 0.01 significance level, whereas it is certainly rejected at the 0.05 significance level.

Table 8-4 ANOVA Test for the Four Groups among the Four Samples

GROUPS		Board of Directors		Chief Executive Officers		Audit Committee Members		Shareholders		F	
		Mean	S.D	Mean	S.D	Mean	S.D	Mean	S.D	Value	Sig.
8.4. A	Shareholder Rights	4.02	.523	4.11	.427	3.64	.620	3.61	.647	**7.49**	**.000**
8.4. B	Board of Directors	4.01	.395	3.92	.428	3.62	.562	3.56	.527	**8.21**	**.000**
8.4. C	Audit Committee and Internal Audit	3.81	.464	3.83	.457	3.67	.580	3.57	.521	**2.87**	**.037**
8.4. D	Disclosure and Transparency	3.98	.521	4.10	.417	3.61	.588	3.55	.701	**7.38**	**.000**
Overall	Corporate Governance (8.4.A, 8.4.B, 8.4.C and 8.4.D)	**3.95**	**.378**	**3.99**	**.330**	**3.64**	**.488**	**3.57**	**.531**	**8.50**	**.000**
No. Of Participants		44		15		54		123		---	

$F_{Critical} = F_{(\alpha,v1,v2)} = F_{(0.05,3,232)} = \mathbf{2.60}$ (Appendix 2)

The final Group, 8.4.D, is also significant since the p-value was 0.000 and the observed F-value, 7.38, is greater than the critical F-value, 2.60, so it again falls into the rejection region. The last null hypothesis that there is no significant difference in the mean values between the four samples with respect to the fourth mechanism of corporate governance, disclosure and transparency, ($H_{o\ D\&T}$: $\mu_{board} = \mu_{ceo} = \mu_{audit} = \mu_{share}$) is, therefore, rejected.

The combination of the results of the four mechanisms, 8.4.A (shareholders' rights), 8.4.B (board of directors), 8.4.C (audit committee and internal audit) and 8.4.D (disclosure and transparency), represents an evaluation of the effectiveness of corporate governance. The number (Likert Scale 1-5) given to each statement under each group in the questionnaire is implicitly an evaluation of the effectiveness of corporate governance in Saudi Arabia. The final group in Table 8-4, corporate governance, is the average of all the results obtained from the participants. The p-value of 0.000 is significant and the observed F-value, 8.50, is greater than the critical F-value, which means that the null hypothesis that there is no significant difference in the mean values between the four samples with respect to all the four mechanisms of corporate governance is rejected.

The decisions, therefore, from the one-way analysis of variance ANOVA were to reject the null hypotheses. That means that at least one of the mean values is not the same as the other mean values of the four samples. The next question, therefore, is: where does the difference lie? What we need is a way to discover where the differences lie, not just that there is a difference. To know this, some multiple comparison procedures (e.g., post hoc) must be performed. Norusis (2000) claimed that a statistically significant F ratio tells you only that it appears unlikely that all population means are equal. However, it does not tell you which groups are different from each other. Usually when you have rejected the null hypothesis, you want to pinpoint exactly where the differences are. To do this, you must use multiple comparison procedures. The reason for not using many t-tests is that when you make many comparisons involving the same means, the probability increases that one or more comparisons will turn out to be statistically significant, even when all the population means are equal. This is known as the multiple-comparison problem.

When you use a multiple-comparison procedure, you can be more confident that you are finding true differences (Norusis, 2000).

There are two varieties of post hoc techniques: (1) pair-wise; and (2) pair-wise and otherwise. In pair-wise techniques, two means totals only are compared at a time. In the pair-wise and otherwise techniques, minimally one comparison involves more than two conditions (i.e., group 1 + 2 vs. 3). Some caution, however, needs to be exercised with the approach if someone intended to specify a lot of different comparisons. Some techniques do not control for the increased risks of Type I errors. Type I error involves rejecting the null hypothesis (e.g., there are no differences among the samples), when it is actually true. In other words, there is an increased risk of thinking that you have found a significant result when in fact it could have occurred by chance. The Scheffe test is the most cautious method for reducing the risk of a Type 1 error (Bryman and Cramer, 2004).

Diamantopoulos and Schlegelmilch (2000: 190) after describing many multiple comparison tests stated, "stick to the commonly used Scheffe and Tukey tests and you cannot go wrong". Although the Tukey test is only usable when the sample sizes are the same, the Scheffe test is customarily used with equal and unequal sample sizes. Therefore, the Scheffe test has been used to compare the means between every two groups to identify which one is different. The results of the Scheffe test are shown in Table 8-5.

Table 8-5 The Results of the Scheffe Test

GROUPS	Group (I)	Group (J)	Mean Difference (I-J)	Sig.	Result
Group 8-5.A. Shareholder Rights	BDs	CEOs	-0.08	0.975	1 = 2
		ACMs	0.39	0.019*	1 > 3
		SHRs	0.42	0.002*	1 > 4
	CEOs	BDs	0.08	0.975	2 = 1
		ACMs	0.48	0.068	2 = 3
		SHRs	0.50	0.031*	2 > 4
	ACMs	BDs	-0.39	0.019*	3 < 1
		CEOs	-0.48	0.068	3 = 2
		SHRs	0.02	0.996	3 = 4
	SHRs	BDs	-0.42	0.002*	4 < 1
		CEOs	-0.50	0.031*	4 < 2
		ACMs	-0.02	0.996	4 = 3
Group 8-5.B. Board of Directors	BDs	CEOs	0.03	0.997	1 = 2
		ACMs	0.34	0.014*	1 > 3
		SHRs	0.40	0.000*	1 > 4
	CEOs	BDs	-0.03	0.997	2 = 1
		ACMs	0.30	0.241	2 = 3
		SHRs	0.37	0.074	2 = 4
	ACMs	BDs	-0.34	0.014*	3 < 1
		CEOs	-0.30	0.241	3 = 2
		SHRs	0.06	0.902	3 = 4
	SHRs	BDs	-0.40	0.000*	4 < 1
		CEOs	-0.37	0.074	4 = 2
		ACMs	-0.06	0.902	4 = 3

Group 8-5.C. Audit Committee and Internal Audit	BDs	CEOs	-0.02	1.000	**1 = 2**
		ACMs	0.14	0.638	**1 = 3**
		SHRs	0.24	0.086	**1 = 4**
	CEOs	BDs	0.02	1.000	**2 = 1**
		ACMs	0.16	0.786	**2 = 3**
		SHRs	0.26	0.363	**2 = 4**
	ACMs	BDs	-0.14	0.638	**3 = 1**
		CEOs	-0.16	0.786	**3 = 2**
		SHRs	0.10	0.720	**3 = 4**
	SHRs	BDs	-0.24	0.086	**4 = 1**
		CEOs	-0.26	0.363	**4 = 2**
		ACMs	-0.10	0.720	**4 = 3**
Group 8.5.D Disclosure and Transparency	BDs	CEOs	-0.13	0.930	**1 = 2**
		ACMs	0.37	0.045*	**1 > 3**
		SHRs	0.42	0.003*	**1 > 4**
	CEOs	BDs	0.13	0.930	**2 = 1**
		ACMs	0.49	0.070	**2 = 3**
		SHRs	0.55	0.019*	**2 > 4**
	ACMs	BDs	-0.37	0.045*	**3 < 1**
		CEOs	-0.49	0.070	**3 = 2**
		SHRs	0.06	0.956	**3 = 4**
	SHRs	BDs	-0.42	0.003*	**4 < 1**
		CEOs	-0.55	0.019*	**4 < 2**
		ACMs	-0.06	0.956	**4 = 3**

Groups 8.5.A, 8.5.B, 8.5.C& 8.5.D Corporate Governance	BDs	CEOs	-0.05	0.990	**1 = 2**
		ACMs	0.31	0.022*	**1 > 3**
		SHRs	0.37	0.000*	**1 > 4**
	CEOs	BDs	0.05	0.990	**2 = 1**
		ACMs	0.36	0.098	**2 = 3**
		SHRs	0.42	0.021*	**2 > 4**
	ACMs	BDs	-0.31	0.022*	**3 < 1**
		CEOs	-0.36	0.098	**3 = 2**
		SHRs	0.06	0.899	**3 = 4**
	SHRs	BDs	-0.37	0.000*	**4 < 1**
		CEOs	-0.42	0.021*	**4 < 2**
		ACMs	-0.06	0.899	**4 = 3**

Note	*	Significant at 0.05
	BDs	Board of Director Members
	CEOs	Chief Executive Officers
	ACMs	Audit Committee Members
	SHRs	Shareholders

The last section in Table 8-5, corporate governance, represents the average scores of the four groups/mechanisms (8.5.A, 8.5.B, 8.5.C and 8.5.D) of corporate governance, which are shareholders' rights, board of directors, audit committee and internal audit and disclosure and transparency. Table 8-5 shows that there is no significant difference in the perception of the board of director members and the chief executive officers toward this group, corporate governance. This confirms that the null hypothesis that there is no significant difference between the board of director members and the chief executive officers and conclude that they are likely to have similar evaluation of corporate governance in Saudi joint stock corporations.

However, there seems to be a significant difference in the perception of the board of directors, the audit committee members and the shareholders. The associated p-values of 0.022 and 0.000 confirm that difference. Therefore, the board of directors and the audit committee members are likely to have different evaluation of corporate governance, and the same could be said for the board of director members and the shareholders.

There is no significant difference in the perception between the chief executive officers and the audit committee members about the effectiveness of corporate governance in Saudi joint stock corporations, whereas the chief executive officers were more positive in their evaluation of corporate governance than the shareholders were. The audit committee members also had the same opinion in regards to corporate governance compared to the opinion of shareholders.

It could be concluded that in 12 pair comparisons regarding the final group, corporate governance, 6 comparisons (50%) were significant. On the other hand, there were 6 comparisons (50%) that were not significant.

Shareholders are the legal owners of a public company. The scores given by the shareholders are valuable information for both Saudi joint stock corporations and the regulators of corporate governance in Saudi Arabia since their scores reflect how confident they were about corporate governance in those corporations. It also reflects their satisfaction and their ability to practise their rights. Corporate governance is in practice a matter for directors, not shareholders, and shareholders are concerned with value and the effect of things like governance on that value.

Modigliani and Perotti (1996) showed how the development of the equity markets in different countries depends on how well laws protect the property rights of minority shareholders. Furthermore, La Porta et al. (1996, 1998) showed that in countries where legal institutions are under-developed and where the enforcement of laws cannot be relied upon, it is not sufficient to analyze the legal framework when examining whether shareholder rights are protected. Instead, it is necessary to find indicators that reflect the actual behaviour of management towards outside shareholders.

The findings of this study indicate that the participating shareholders were less confident in their evaluation of the effectiveness of corporate governance since their average mean scores were less than the average scores of the other three samples participating in this study. The last few rows in Table 8-5 confirm this reality since the difference in the average mean values between the shareholders and the board of directors with respect to corporate governance was highly significant and negative (-0.37). That means that the average mean values obtained from the board of director members was more than the average mean value of the shareholders, which indicates that the board of directors were more confident about the effectiveness of corporate governance than the shareholders. The same thing could be said about the shareholders and the chief executive officers (Table 8-5). Although the audit committee members were closer to the shareholders in their evaluation of corporate governance and the difference in the mean scores was not significant (Table 8-5), the difference still negative (-0.06).

It could be concluded that if shareholder rights are to be enhanced, a clarification of the responsibilities of corporate directors and managers is necessary. Various examples of corporate collapse regionally and internationally have shown that issues in corporate governance cannot be treated in isolation but are interrelated. Thus, enhancing shareholder powers will be futile in the long term if corporate managers and directors do not realise the full extent of their legal responsibilities.

8.3. FURTHER ANALYSIS

The analysis of frequency distributions in Chapter 7 was used as a method to classify the participants and to summarize just one part of the collected data, the demographic questions. Then several tables were presented to summarize the differences in the mean values with relation to the other part of the collected data, the corporate governance data. This chapter was mainly concerned with testing the hypotheses by analyzing the corporate governance data. Therefore, the two parts of the collected data (demographic and corporate governance) were analyzed, so far, in isolation.

Further analysis, however, will overcome this concern by involving the demographic data as well as the corporate governance data at the same time in the analysis to investigate the differences in the mean values of the corporate governance data with appreciation of the demographic data. In different words, this analysis will answer questions like: Do the responses to the first mechanism of corporate governance, shareholder rights, differ between highly educated and normally educated participants? Do they differ between old and young participants? Does experience effect responses? What about the other mechanisms of corporate governance? If differences exist, are they significant? These questions and more will be investigated in the following analysis.

8.3.1. Tests for Differences in Means and Variances (Heterogeneity and Homogeneity of Variance) with Appreciation to the Demographic Questions

Differences in the mean values may exist within one sample between different characteristics of the participants. Highly educated chief executive officers (CEOs), for example, may have different perspectives than CEOs with bachelor or less educational qualifications. Differences also may exist between two samples or more. Experienced board members with ten years or more in their current jobs may be more positive in their evaluation of the effectiveness of corporate governance than experienced audit committee members.

Differences in variances may also exist between samples. One of the assumptions of analysis of variance is that variances of the observations in the individual groups are equal, a situation referred to as 'homogeneity' of variance. Of equal importance to its role in satisfying the assumptions of ANOVA, homogeneity of group variances, or the absence of it, may be of equal scientific interest as whether or not the means of the groups are equal.

8.3.1.1. Differences between Highly Educated Members and Members with Bachelor or Less

Table 8-6 presents the results of the independent-samples t-test that was run to investigate whether there are significant differences in mean values and variations (heterogeneity and homogeneity of variance) between the participants' responses to the four mechanisms of corporate governance (shareholders' rights, board of directors, audit committee and internal audit and disclosure and transparency) with respect to the educational qualifications of those participants.

Table 8-6 Mean and Variance Differences with respect to Educational Qualification

SAMPLE	GROUP	SUB-GROUP	N	Mean	Diff. In Means	Levene's test for equality of variances		t-test for equality of means	
						F	Sig.	t	Sig.
Board of Director Members	SHRs	High Educ.	18	3.93	-0.17	1.41	.242	-1.07	.290
		≥ Bachelor	26	4.10					
	BDs	High Educ.	18	3.93	-0.17	1.41	.242	-1.07	.290
		≥ Bachelor	26	4.10					
	AC&IA	High Educ.	18	3.94	0.22	1.92	.173	1.56	.127
		≥ Bachelor	26	3.72					
	D&T	High Educ.	18	3.92	-0.10	2.97	.092	-0.60	.551
		≥ Bachelor	26	4.02					
	Overall	High Educ.	18	3.92	-0.03	0.56	.457	-0.27	.789
		≥ Bachelor	26	3.96					
Chief Executive Officers	SHRs	High Educ.	5	4.05	-0.09	0.63	.442	-0.36	.725
		≥ Bachelor	10	4.14					
	BDs	High Educ.	5	4.05	-0.09	0.63	.442	-0.36	.725
		≥ Bachelor	10	4.14					
	AC&IA	High Educ.	5	4.04	0.31	1.18	.297	1.28	.223
		≥ Bachelor	10	3.73					
	D&T	High Educ.	5	4.45	0.53	0.66	.431	2.82	* .014
		≥ Bachelor	10	3.93					
	Overall	High Educ.	5	4.16	0.25	0.02	.879	1.43	.178
		≥ Bachelor	10	3.91					

Audit Committee Members	**SHRs**	High Educ.	10	3.89	0.32	1.30	.260	1.48	.145
		≥ Bachelor	44	3.58					
	BDs	High Educ.	10	3.89	.32	1.30	.260	1.48	.145
		≥ Bachelor	44	3.58					
	AC&IA	High Educ.	10	3.43	-030	1.77	.676	-1.51	.136
		≥ Bachelor	44	3.73					
	D&T	High Educ.	10	3.36	-0.31	2.48	.122	-1.50	.138
		≥ Bachelor	44	3.67					
	Overall	High Educ.	10	3.54	-0.12	.003	.959	-0.70	.486
		≥ Bachelor	44	3.66					
Shareholders	**SHRs**	High Educ.	30	3.79	0.23	7.00	* .009	2.21	* 0.03
		≥ Bachelor	93	3.55					
	BDs	High Educ.	30	3.79	0.23	7.00	* .009	2.21	* 0.03
		≥ Bachelor	93	3.55					
	AC&IA	High Educ.	30	3.55	-0.04	1.49	.225	-0.35	.728
		≥ Bachelor	93	3.58					
	D&T	High Educ.	30	3.53	-0.03	1.14	.288	-0.21	.838
		≥ Bachelor	93	3.56					
	Overall	High Educ.	30	3.62	0.06	0.11	.739	0.55	.582
		≥ Bachelor	93	3.56					
Overall Samples	**SHRs**	High Educ.	64	3.85	0.17	7.79	* .006	2.18	* .031
		≥ Bachelor	172	3.68					
	BDs	High Educ.	64	3.85	0.17	7.79	* .006	2.18	* .031
		≥ Bachelor	172	3.68					
	AC&IA	High Educ.	64	3.69	0.05	6.58	* .011	0.58	.565
		≥ Bachelor	172	3.64					
	D&T	High Educ.	64	3.69	0.02	2.88	.091	0.22	.823
		≥ Bachelor	172	3.67					
	Overall	High Educ.	64	3.74	0.07	0.00	.984	1.01	.315
		≥ Bachelor	172	3.66					

Note	*	Significant at 0.05
	N	Number of People in Each Group
	SHRs	Group 1: Shareholders' Rights
	BDs	Group 2: Board of Directors
	AC&IA	Group 3: Audit Committee and Internal Audit
	D&T	Group 4: Disclosure and Transparency

The second column from the right in Table 8-6 labelled 'Levene's Test for Equality of Variances' tests whether the variance or variation of scores for the two sub-groups (Highly Educated and Bachelor or Less) is the same (Kinnear et al., 2000). The results shown in this column determined which of the t-value (t-value with equal variance assumed or t-value with equal variance not assumed) is the correct one to use. It is therefore a test for the homogeneity of variance assumption of a valid t-test (Pallant, 2001). According to Pallant (2001: p.179) and Kinnear and Gray (2000: p.160), the decision rules are:

- If the Sig. value is larger than 0.05 ($p > 0.05$), then the homogeneity of variance assumption has not been violated and the normal t-test based on equal variance (Equal Variances Assumed) is used.
- If the Sig. value equals or less than 0.05 ($p \leq 0.05$, then the homogeneity of variance assumption has been violated and the normal t-test based on equal variances should be replaced by one based on separate variance estimates (Equal Variances not Assumed).

The previous decision rules have been considered and the t-values shown in the first column of the last section in Table 8-6 labelled 't-test for equality of means' are the appropriate values based on the significance of the p-value of the Levene's Test for Equality of Variances. There were only five significant p-values of Levene's Test in Table 8-6 (the significant p-values were marked by '*'). With those five cases, the homogeneity of variance assumption was violated and the normal t-test based on equal variances has been replaced by the t-test based on separate variance estimates (Equal Variances not Assumed).

The 'N' column in the Table gives the number of people in each group. In the first sample, board of director members, there were 18 highly educated participants and 26 people with bachelor or less. It seems that the highly educated board members were more realistic than participants with only bachelor or less since the differences in the mean values of the first sample were negative three times (-0.17, -0.17 and –0.10) and positive just once (0.22). The negative signs mean that the average mean values of the responses obtained from the highly educated board members were less in value than the average mean values of the responses obtained from the members with bachelor or less. The p-values of the Levene's Test for Equality of Variances were insignificant in all groups, so the homogeneity of variance assumption was not violated and the normal t-test based on equal variances has been adopted in all group of the first sample. The insignificant p-values of the t-test for Equality of Means of the first sample, board members, indicate that the difference in mean values between the two sub-groups (highly educated and bachelor or less) were not significant. That, in different words, means that the highly educated board members and those with bachelor or less had almost always the same perspectives towards the effectiveness of corporate governance in Saudi joint stock corporations.

The highly educated chief executive officers (CEOs) were even more positive in their evaluation to the effectiveness of the four mechanisms of corporate governance than the board members because the overall mean values of groups of the highly educated CEOs (4.16) are obviously greater than the board members' (3.92). In fact, the highly educated CEOs were even more positive than the highly educated audit committee members (3.54) and the highly educated shareholders (3.62). The only one significant p-value of the t-test in the second sample, CEOs, which relates to the disclosure and transparency, indicates that the highly educated CEOs and those with bachelor and less had different views about this mechanism of corporate governance, disclosure and transparency.

The insignificant p-values of the t-test of the third sample, audit committee members, in Table 8-6 mean that the differences in the mean values between the highly educated audit committee members and those with bachelor or less were not significant. That indicates that the two sub-groups in this sample had the same perspectives regarding all mechanisms of corporate governance.

The final sample, shareholders, in Table 8-6 had two significant p-values of the t-test (0.03 and 0.03). That means that the highly educated shareholders were significantly more confident about the first two mechanisms of corporate governance, shareholder rights and board of directors, than the shareholders with bachelor or less. That might be related to the fact that highly educated shareholders are more likely to understand their expected rights than those less educated shareholders.

The results shown in the last row (overall groups row) of the last section in the first column (overall samples section) in Table 8-6 give a general view to the difference between the highly educated and less educated participants. The p-value of the t-test of .315 indicates that, in general, it could be said that the highly educated and less educated members had no significantly different opinions regarding the effectiveness of the four mechanisms of corporate governance. This p-value, .315, means that the difference between the first mean value of 3.74 and the mean value of 3.66 is not significant.

8.3.1.2. Differences between Members with Business-Related Specialization and Non-Business-Related Educational Qualification

Table 8-7 presents the results of the independent-samples t-test that was run to investigate whether there are significant differences in mean values and variations (heterogeneity and homogeneity of variance) between the participants' responses to the four mechanisms of corporate governance (shareholders' rights, board of directors, audit committee and internal audit and disclosure and transparency) with respect to the educational qualifications of those participants. In different words, the Table presents the differences between members with business-related educational qualification (e.g., Accounting, Economics, Business and Administration, etc.) and members with different education backgrounds (e.g., History, Politics, Psychology, Law, etc.).

Table 8-7 Mean and Variance Differences with respect to Educational Specialization

SAMPLE	GROUP	SUB-GROUP	N	Mean	Diff. In Means	Levene's test for equality of variances		t-test for equality of means	
						F	Sig.	t	Sig.
Board of Director Members	SHRs	Busi. related	20	3.98	-0.09	6.61	* .014	-0.57	.571
		Non-Busi.	24	4.07					
	BDs	Busi. related	20	3.98	-0.09	6.61	* .014	-0.57	.571
		Non-Busi.	24	4.07					
	AC&IA	Busi. related	20	4.07	0.47	0.10	.757	3.81	* .000
		Non-Busi.	24	3.60					
	D&T	Busi. related	20	4.19	0.39	0.11	.738	2.61	* .013
		Non-Busi.	24	3.80					
	Overall	Busi. related	20	4.07	0.24	0.06	.803	2.20	* .034
		Non-Busi.	24	3.83					
Chief Executive Officers	SHRs	Busi. related	9	3.97	-0.35	0.61	.448	-1.66	.121
		Non-Busi.	6	4.32					
	BDs	Busi. related	9	3.97	-0.35	0.61	.448	-1.66	.121
		Non-Busi.	6	4.32					
	AC&IA	Busi. related	9	3.68	-0.37	0.01	.934	-1.65	.124
		Non-Busi.	6	4.06					
	D&T	Busi. related	9	3.95	-0.39	0.22	.645	-1.91	.078
		Non-Busi.	6	4.33					
	Overall	Busi. related	9	3.84	-0.38	0.30	.592	-2.62	* .021
		Non-Busi.	6	4.22					
Audit Committee Members	SHRs	Busi. related	30	3.48	-0.35	0.27	.608	-2.11	* .039
		Non-Busi.	24	3.83					
	BDs	Busi. related	30	3.48	-0.35	0.27	.608	-2.11	* 0.39
		Non-Busi.	24	3.83					

	AC&IA	Busi. related	30	3.73	0.13	2.34	.132	0.84	.406
		Non-Busi.	24	3.60					
	D&T	Busi. related	30	3.60	-0.03	0.59	.447	-0.19	.844
		Non-Busi.	24	3.63					
	Overall	Busi. related	30	3.60	-0.08	0.27	.607	-0.56	.576
		Non-Busi.	24	3.68					
Shareholders	**SHRs**	Busi. related	56	3.67	0.11	0.96	.328	0.95	.344
		Non-Busi.	67	3.56					
	BDs	Busi. related	56	3.67	0.11	0.96	.328	0.95	.344
		Non-Busi.	67	3.56					
	AC&IA	Busi. related	56	3.75	0.32	0.97	.326	3.50	* .001
		Non-Busi.	67	3.43					
	D&T	Busi. related	56	3.74	0.34	12.3	* .001	2.80	* .006
		Non-Busi.	67	3.40					
	Overall	Busi. related	56	3.71	0.25	4.84	* .030	2.70	* .008
		Non-Busi.	67	3.46					
Overall Samples	**SHRs**	Busi. related	115	3.70	-0.05	7.14	* .008	-0.65	.519
		Non-Busi.	121	3.75					
	BDs	Busi. related	115	3.70	-0.05	7.14	* .008	-0.65	.519
		Non-Busi.	121	3.75					
	AC&IA	Busi. related	115	3.79	0.26	1.12	.291	3.97	* .000
		Non-Busi.	121	3.53					
	D&T	Busi. related	115	3.79	0.22	14.8	* .000	2.68	* .008
		Non-Busi.	121	3.57					
	Overall	Busi. related	115	3.75	0.14	6.74	* .010	2.14	* .033
		Non-Busi.	121	3.61					

Note	*	Significant at 0.05
	N	Number of People in Each Group
	SHRs	Group 1: Shareholders' Rights
	BDs	Group 2: Board of Directors
	AC&IA	Group 3: Audit Committee and Internal Audit
	D&T	Group 4: Disclosure and Transparency

There is no doubt that being a member of a board, a chief executive officer, an audit committee member or a shareholder means that you must have a good deal of financial and business literacy because those people are always dealing with numbers and financial statements. Davidson and Ebersole (2000) argued that the audit committee's understanding of accounting matters and internal controls over financial reporting (its financial literacy) is strongly related to effectiveness. Hurtt et al (1999) claimed that financial literacy for company players consists of "the ability to read and understand fundamental financial statements, including a company's balance sheet, income statement, and cash flows statement" (pp. 124). The Blue Ribbon Committee (1999) suggested that members of the audit committee with limited familiarity with finance could achieve financial literacy through company-sponsored training programmes. This level of literacy can also be achieved through completion of a basic financial accounting course such as those taught in most MBA programmes at colleges and universities (Hurtt et al, 1999). Financially literate participants with business related educational qualifications were thought to be more likely to meet their responsibilities, understand their business matters, effectively play their expected roles in their companies and finally be more effective in enhancing the effectiveness of corporate governance.

The number of board members with business-related educational qualifications as shown in Table 8-7 was 20 and the non-business-related qualified members were 24. The business-educated board members' responses to the first and second groups (shareholder rights and board of directors) were less in mean average (3.98 and 3.98, respectively) than the non-business-educated members (4.07 and 4.07, respectively), and their responses to the third and fourth groups (audit committee and internal audit and disclosure and transparency) were more in mean value (4.07 and 4.19, respectively) than the non-business-educated members (3.60 and 3.80, respectively). The highest difference in the mean values between business-related and non-business-related board members was the one regarding audit committee and internal audit group, 0.47. The business-educated board members were highly more confident than the non-business-educated members towards this group, C. The Levene's F-values of the first two groups/mechanisms of corporate governance (SHRs and BDs) were significant at 0.05 level, so the homogeneity of variance assumption was violated and the normal t-test based on equal variances has been replaced with the t-test based on unequal variance for these two group. The other two groups (AC&IA and D&T) were significant, so the heterogeneity of variance assumption was violated and the homogeneity of variance assumption was not violated, therefore, the normal t-test based on equal variances has been adopted. The p-values of the t-test for these last two groups (AC&IA and D&T) were significant, so the difference in the mean values between the business educated board members and the non-business educated members was significant.

The insignificant p-values of the t-test for Equality of Means of the second sample, chief executive officers, in Table 8-7 indicate that the difference in mean values between the two sub-groups (business-related and non-business-related qualifications) were not significant. That, in different words, means that the business-educated chief executive officers and those with non-business qualifications had almost always the same perspectives towards the effectiveness of corporate governance in Saudi joint stock corporations.

The final two samples, audit committee members and shareholders, were almost the same. The significant two p-values of the first two groups (SHRs and BDs) in sample 3 (audit committee members) indicate that the business-educated audit committee members were significantly more negative than the non-business-educated audit committee members in regards of these two groups, SHRs and BDs. The differences in the mean values of the last two groups (AC&IA and D&T) in sample 4 (shareholders) were significant, so the business-educated shareholders were significantly more positive in their evaluation to the effectiveness of the last two mechanisms of corporate governance than the non-business-educated shareholders.

The overall results shown in the last row of the last section in Table 8-7 give an impression that the business-related qualified participants were significantly more positive in their evaluation the effectiveness of the mechanisms of corporate governance than the non-business-related qualified participants. That could be seen by the fact that the difference in the mean values between the business and non-business sub-groups was 0.14 and the p-value of the t-test (.033) was significant.

Therefore, it could be concluded that the findings of this study indicated that the business-qualified participants were more positive in their evaluation of the effectiveness of corporate governance in Saudi joint stock corporations than the participants with non-business-related qualifications.

8.3.1.3. Differences between Members Who Achieved their Highest Level of Education from Saudi Arabia and those from Somewhere Else

Table 8-8 presents the results of the independent-samples t-test that was run to investigate whether there are significant differences in mean values and variations (heterogeneity and homogeneity of variance) between the participants' responses to the four mechanisms of corporate governance (shareholders' rights, board of directors, audit committee and internal audit and disclosure and transparency) with respect to the country of highest education achieved. In different words, the Table presents the differences between members who received their highest level of education from Saudi Arabia and those who received their highest education from other countries (e.g. U.S.A, U.K., Australia, etc.).

Table 8-8 Mean and Variance Differences with Respect to Country of Highest Level of Education Achieved

SAMPLE	GROUP	SUB-GROUP	N	Mean	Diff. In Means	Levene's test for equality of variances		t-test for equality of means	
						F	Sig.	t	Sig.
Board of Director Members	SHRs	Saudi Arabia	24	4.25	0.49	0.19	.733	3.47	* .001
		Other	20	3.76					
	BDs	Saudi Arabia	24	4.25	0.49	0.19	.733	3.47	* .001
		Other	20	3.76					
	AC&IA	Saudi Arabia	24	3.76	-0.11	0.03	.862	-0.79	.431
		Other	20	3.87					
	D&T	Saudi Arabia	24	4.03	0.11	0.63	.431	0.72	.475
		Other	20	3.91					
	Overall	Saudi Arabia	24	4.01	0.15	1.14	.291	1.34	.188
		Other	20	3.86					

Chief Executive Officers	SHRs	Saudi Arabia	7	4.28	0.31	0.01	.940	1.46	.169
		Other	8	3.97					
	BDs	Saudi Arabia	7	4.28	0.31	0.01	.940	1.46	.169
		Other	8	3.97					
	AC&IA	Saudi Arabia	7	3.89	0.10	0.39	.542	0.42	.681
		Other	8	3.78					
	D&T	Saudi Arabia	7	4.03	-0.14	0.04	.836	-0.63	.542
		Other	8	4.17					
	Overall	Saudi Arabia	7	4.03	0.07	0.76	.399	0.41	.686
		Other	8	3.96					
Audit Committee Members	SHRs	Saudi Arabia	34	3.58	-0.16	22.4	*.000	-1.11	.274
		Other	20	3.73					
	BDs	Saudi Arabia	34	3.58	-0.16	22.4	*.000	-1.11	.274
		Other	20	3.73					
	AC&IA	Saudi Arabia	34	3.45	-0.60	0.45	.507	-4.24	*.000
		Other	20	4.05					
	D&T	Saudi Arabia	34	3.47	-0.38	30.6	*.000	-2.95	*.005
		Other	20	3.85					
	Overall	Saudi Arabia	34	3.49	-0.38	11.2	*.002	-3.51	*.001
		Other	20	3.87					
Shareholders	SHRs	Saudi Arabia	83	3.53	-0.24	9.70	*.002	-2.31	*.023
		Other	40	3.77					
	BDs	Saudi Arabia	83	3.53	-0.24	9.70	*.002	-2.31	*.023
		Other	40	3.77					
	AC&IA	Saudi Arabia	83	3.43	-0.44	1.44	.233	-4.71	*.000
		Other	40	3.87					
	D&T	Saudi Arabia	83	3.38	-0.52	43.9	*.000	-5.22	*.000
		Other	40	3.90					
	Overall	Saudi Arabia	83	3.44	-0.41	20.3	*.000	-5.17	*.000
		Other	40	3.85					
Overall Samples	SHRs	Saudi Arabia	148	3.69	-0.08	27.3	*.000	-1.14	.257
		Other	88	3.78					
	BDs	Saudi Arabia	148	3.69	-0.08	27.3	*.000	-1.14	.257
		Other	88	3.78					

AC&IA	Saudi Arabia	148	3.51	-0.39	1.99	.159	-5.91	* .000
	Other	88	3.90					
D&T	Saudi Arabia	148	3.54	-0.38	48.9	* .000	-5.13	* .000
	Other	88	3.92					
Overall	Saudi Arabia	148	3.57	-0.29	25.0	* .000	-5.06	* .000
	Other	88	3.87					

Note	*	Significant at 0.05
	N	Number of People in Each Group
	SHRs	Group 1: Shareholders' Rights
	BDs	Group 2: Board of Directors
	AC&IA	Group 3: Audit Committee and Internal Audit
	D&T	Group 4: Disclosure and Transparency

In a general comparison, it seems that the board members and the chief executive officers (CEOs) who achieved their highest level of education from Saudi Arabia were more positive in their evaluation to the effectiveness of corporate governance in Saudi Arabia than those who received their highest level of education from another country because the differences between the two sub-groups (Saudi Arabia and other) were positive in three groups and negative in just one group. The members who achieved their highest level of education from Saudi Arabia in the other two samples (the audit committee members and the shareholders), however, were less confident about the effectiveness of corporate governance than the members who achieved their highest level of education from somewhere else since all the differences in the mean values between the two sub-samples were negative for all groups.

The p-values of the t-test for equality of means of the second sample, the chief executive officers, were not significant in all groups, whereas the p-values of the fourth sample, the shareholders, were significant in all groups. That suggests that the differences in the mean values between the two sub-groups were significant in the second samples and were insignificant in the fourth sample. In different words, the chief executive officers who achieved their highest level of education in Saudi Arabia had no different opinion towards the effectiveness of corporate governance than those who got their highest education somewhere else. The significant differences, however, in the mean values between the two sub-samples of the fourth sample suggest that the shareholders had different perspectives regarding corporate governance. It also could be noticed that the mean values of the shareholders' responses to the groups of corporate governance were in general less than the mean values of the other participants' responses. That means that the shareholders' evaluation to the effectiveness of corporate governance not only fluctuated between the two sub-samples (Saudi Arabia and other) but also was less confident than the evaluation of the participants in the other three samples.

The last row in Table 8-8 (overall groups) in the last section (overall samples) gives an overall look at the difference between the two sub-samples with respect to all samples. The value of the difference in the mean was –0.29 which means that the participants who achieved their highest level of education from Saudi Arabia were less confident about the effectiveness of the four mechanisms of corporate governance than the participants who achieved their highest level of education from different countries. The p-value of 0.000 of the t-test means that this difference is highly significant. Why do the two sub-groups have a significantly high difference? It is difficult to answer this question and to interpret the reason why the difference exists and why it is significant. That could be by chance or it could be because the participants who achieved their highest education from Saudi Arabia had different views of corporate governance than those who received their highest education from another country. It might be due to the understanding of corporate governance or the understanding of the importance of the four mechanisms in developing and enhancing corporate governance. The Saudi educated participants may be more cautious than the other participants.

8.3.1.4. Differences between Members with 11+ Years Experience and those with 10 Years or Less

Table 8-9 presents the results of the independent-samples t-test that was run to investigate whether there are significant differences in mean values and variations between the participants' responses to the four mechanisms of corporate governance (shareholders' rights, board of directors, audit committee and internal audit and disclosure and transparency) with respect to the experience of those participants. In different words, the Table presents the differences between members with 11-year experience and members with 10 years or less experience in their current jobs.

Table 8-9 Mean and Variance Differences with Respect to Experience

SAMPLE	GROUP	SUB-GROUP	N	Mean	Diff. In Means	Levene's test for equality of variances		t-test for equality of means	
						F	Sig.	t	Sig.
Board of Director Members	SHRs	≥ 11 years	28	4.10	0.21	4.25	* .045	1.13	.272
		≤ 10 years	16	3.89					
	BDs	≥ 11 years	28	4.10	0.21	4.25	* .045	1.13	.272
		≤ 10 years	16	3.89					
	AC&IA	≥ 11 years	28	3.92	0.31	0.77	.386	2.21	* .033
		≤ 10 years	16	3.62					
	D&T	≥ 11 years	28	4.08	0.29	0.25	.621	1.82	.076
		≤ 10 years	16	3.79					
	Overall	≥ 11 years	28	4.05	0.28	1.53	.224	2.55	* .015
		≤ 10 years	16	3.76					
Chief Executive Officers	SHRs	≥ 11 years	13	4.18	0.55	0.46	.509	1.84	.089
		≤ 10 years	2	3.63					
	BDs	≥ 11 years	13	4.18	0.55	0.46	.509	1.84	.089
		≤ 10 years	2	3.63					
	AC&IA	≥ 11 years	13	3.93	0.77	0.32	.580	2.64	* .021
		≤ 10 years	2	3.17					
	D&T	≥ 11 years	13	4.13	0.23	2.34	.150	0.72	.482
		≤ 10 years	2	3.90					
	Overall	≥ 11 years	13	4.05	0.43	3.21	.097	1.84	.089
		≤ 10 years	2	3.62					
Audit	SHRs	≥ 11 years	28	3.84	0.42	0.94	.337	2.64	* .011
		≤ 10 years	26	3.42					

Committee Members	**BDs**	≥ 11 years	28	3.84	0.42	0.94	.337	2.64	* .011
		≤ 10 years	26	3.42					
	AC&IA	≥ 11 years	28	3.73	0.12	4.71	* .035	0.77	.446
		≤ 10 years	26	3.61					
	D&T	≥ 11 years	28	3.73	0.26	7.12	* .010	1.60	.116
		≤ 10 years	26	3.48					
	Overall	≥ 11 years	28	3.77	0.28	5.58	* .022	2.15	* .037
		≤ 10 years	26	3.49					
Shareholders	**SHRs**	≥ 11 years	78	3.71	0.26	0.02	.894	2.18	* .031
		≤ 10 years	45	3.45					
	BDs	≥ 11 years	78	3.71	0.26	0.02	.894	2.18	* .031
		≤ 10 years	45	3.45					
	AC&IA	≥ 11 years	78	3.64	0.17	3.16	.078	1.75	.082
		≤ 10 years	45	3.47					
	D&T	≥ 11 years	78	3.64	0.24	2.08	.152	1.88	.063
		≤ 10 years	45	3.40					
	Overall	≥ 11 years	78	3.65	0.22	0.48	.492	2.23	* .028
		≤ 10 years	45	3.44					
Overall Samples	**SHRs**	≥ 11 years	147	3.85	0.33	2.13	.146	3.98	* .000
		≤ 10 years	89	3.52					
	BDs	≥ 11 years	147	3.85	0.33	2.13	.146	3.98	* .000
		≤ 10 years	89	3.52					
	AC&IA	≥ 11 years	147	3.74	0.21	4.34	* .038	2.82	* .005
		≤ 10 years	89	3.53					
	D&T	≥ 11 years	147	3.79	0.28	7.13	* .008	3.20	* .002
		≤ 10 years	89	3.50					
	Overall	≥ 11 years	147	3.78	0.27	4.60	* .033	4.03	* .000
		≤ 10 years	89	3.51					

Note	*	Significant at 0.05
	N	Number of People in Each Group
	SHRs	Group 1: Shareholders' Rights
	BDs	Group 2: Board of Directors
	AC&IA	Group 3: Audit Committee and Internal Audit
	D&T	Group 4: Disclosure and Transparency

The experience of the board members, chief executive officers, audit committee members and shareholders is perceived to be a critical component of effective corporate governance (Beasley and Salterio, 2001; DeZoort, 1997; General Accounting Office, 1991). More experienced participants are more likely to have a better understanding of corporate governance and be able to give a better evaluation of how effective corporate governance is in their corporations.

Unlike the previous Tables, 8-6, 8-7 and 8-8, all the mean differences in all samples and all groups were positive in Table 8-9. That, in fact, confirms that the experienced participants (≥ 11 years) had more positive impressions about the effectiveness of corporate governance in Saudi joint stock corporations than the less experienced participants (≤ 10 years).

The last section in Table 8-9 (Overall Samples) gives the average responses of the four participating samples towards the effectiveness of the four mechanisms of corporate governance (SHRs, BDs, AC&IA and D&T). The differences between the experienced and less experienced participants were positive for all groups as mentioned above and the p-values of the t-test for equality of means were also significant for all groups. Therefore, the differences are positive and significant which indicates that the experienced participants (board members, chief executive officers, audit committee members and shareholders) were more confident about the effectiveness of corporate governance in Saudi Arabia. That is really important since the experienced participants are more likely to understand their corporations and give more accurate evaluations of the mechanisms of corporate governance.

Although the differences in the mean values between the two sub-groups (Saudi Arabia and other) were positive in all samples, the average mean values of the responses are less in the last two samples (audit committee members and shareholders) than the first two samples (board of directors and chief executive officers) which means that the participants in the last two samples were less confident about the effectiveness of corporate governance than the participants in the first two samples. In different words, the experienced audit committee members and shareholders were less satisfied about corporate governance in their corporations than the experienced board members and chief executive officers. The reason might be that the board members and the chief executive officers are in the position of regulating and monitoring corporate governance, whereas the audit committee members are in the position of implementing the decisions made by the management. This reality may lead the board members and the chief executive officers to give a good picture of what they are responsible for, corporate governance.

8.3.1.5. Differences between Members Who are 56+ Years Old and those Who are Younger

Table 8-10 presents the results of the independent-samples t-test that was run to investigate whether there are significant differences in mean values and variations between the participants' responses to the four mechanisms of corporate governance (shareholders' rights, board of directors, audit committee and internal audit and disclosure and transparency) with respect to the age of those participants. In different words, the Table presents the differences between members who are 56 year old or older and members who are 55 years old or younger.

Table 8-10 Mean and Variance Differences with Respect to Age

SAMPLE	GROUP	SUB-GROUP	N	Mean	Diff. In Means	Levene's test for equality of variances		t-test for equality of means	
						F	Sig.	t	Sig.
Board of Director Members	SHRs	≤ 55 years	24	3.91	-0.26	1.77	.190	-1.65	.107
		≥ 56 years	20	4.17					
	BDs	≤ 55 years	24	3.91	-0.26	1.77	.190	-1.65	.107
		≥ 56 years	20	4.17					
	AC&IA	≤ 55 years	24	3.92	0.23	1.16	.287	1.67	.102
		≥ 56 years	20	3.69					
	D&T	≤ 55 years	24	4.03	0.11	1.41	.242	0.72	.475
		≥ 56 years	20	3.91					
	Overall	≤ 55 years	24	3.97	0.05	0.63	.430	0.46	.647
		≥ 56 years	20	3.91					

Chief Executive Officers	**SHRs**	≤ 55 years	12	4.01	-0.50	0.76	.399	-2.00	.067
		≥ 56 years	3	4.51					
	BDs	≤ 55 years	12	4.01	-0.50	0.76	.399	-2.00	.067
		≥ 56 years	3	4.51					
	AC&IA	≤ 55 years	12	3.74	-0.43	2.35	.149	-1.54	.148
		≥ 56 years	3	4.18					
	D&T	≤ 55 years	12	4.06	-0.21	1.16	.302	-0.75	.466
		≥ 56 years	3	4.27					
	Overall	≤ 55 years	12	3.90	-0.46	8.67	* .011	-5.14	* .000
		≥ 56 years	3	4.36					
Audit Committee Members	**SHRs**	≤ 55 years	46	3.59	-0.31	0.29	.593	-1.32	.192
		≥ 56 years	8	3.90					
	BDs	≤ 55 years	46	3.59	-0.31	0.29	.593	-1.32	.192
		≥ 56 years	8	3.90					
	AC&IA	≤ 55 years	46	3.70	0.20	2.91	.094	0.92	.362
		≥ 56 years	8	3.50					
	D&T	≤ 55 years	46	3.61	-0.03	1.66	.203	-0.12	.904
		≥ 56 years	8	3.63					
	Overall	≤ 55 years	46	3.63	-0.04	7.38	* .009	-0.47	.641
		≥ 56 years	8	3.67					
Shareholders	**SHRs**	≤ 55 years	95	3.50	-049	0.11	.745	-3.71	* .000
		≥ 56 years	28	3.99					
	BDs	≤ 55 years	95	3.50	-0.49	0.11	.745	-3.71	* .000
		≥ 56 years	28	3.99					
	AC&IA	≤ 55 years	95	3.54	-0.14	3.47	.065	-1.22	.225
		≥ 56 years	28	3.68					
	D&T	≤ 55 years	95	3.44	-0.47	8.31	* .005	-3.84	* .000
		≥ 56 years	28	3.91					
	Overall	≤ 55 years	95	3.49	-0.36	4.96	* .028	-3.88	* .000
		≥ 56 years	28	3.85					
	SHRs	≤ 55 years	177	3.61	-0.45	0.08	.778	-4.98	* .000
		≥ 56 years	59	4.06					

Overall Samples	**BDs**	≤ 55 years	177	3.61	-0.45	0.08	.778	-4.98	* .000
		≥ 56 years	59	4.06					
	AC&IA	≤ 55 years	177	3.65	-0.03	8.26	* .004	-0.51	.611
		≥ 56 years	59	3.68					
	D&T	≤ 55 years	177	3.61	-0.29	5.49	* .020	-3.34	* .001
		≥ 56 years	59	3.89					
	Overall	≤ 55 years	177	3.62	-0.26	5.50	* .020	-3.99	* .000
		≥ 56 years	59	3.87					

Note	*	Significant at 0.05
	N	Number of People in Each Group
	SHRs	Group 1: Shareholders' Rights
	BDs	Group 2: Board of Directors
	AC&IA	Group 3: Audit Committee and Internal Audit
	D&T	Group 4: Disclosure and Transparency

Koontz (1967) and Juran et al. (1975) said that many corporate boards had too many older, less productive, board members. Research conducted by Cohran, Warwick and Wood (1984) showed a positive correlation, albeit a very weak one, between younger boards of directors and financial performance. Vance (1983), however, argued that a positive correlation exists between financial performance and the average age of directors as a result of greater experience. Research to date on the issue of age, however, is still inconclusive. Therefore, age is an important factor to be investigated alongside other factors such as members experience, education and skills.

It could be noticed from Table 8-10 that the total number of participants who were 55 years old or younger was three times (177) the participants who were 56 years old or older (59). About 45 per cent (20/44) of board of directors, 20 per cent (3/15) of chief executive officers, 15 per cent (8/54) of audit committee members and 23 per cent (28/123) of shareholders aged 56 years or more. The results, therefore, confirm the findings of Koontz (1967) and Juran et al. (1975) that many board of directors had too many older board members (45%), whereas the percentage of older members in the management and the audit committee were much less. Older members, however, do not always mean less productivity, but it could mean more experience.

Although most of the differences in the mean value between the older and younger participants were negative, most of these negative differences were not significant. The negative differences indicate that the participants who were 55 years old or younger were less confident about the effectiveness of corporate governance in Saudi joint stock corporations than those who were 56 years old or older.

In the last section of Table 8-10 (Overall Samples) the p-values of the t-test were negative and significant in three groups (SHRs, BDs and D&T) and negative and insignificant in just one group (AC&IA). That indicates that the younger participants were significantly less confident about the effectiveness of three mechanisms of corporate governance, which are the rights of shareholders, board of directors and disclosure and transparency.

Why were the mean values of the answers obtained from the younger participants always less than the mean values of the answers obtained from the older participants? Does that mean that older participants are just more optimistic about corporate governance and their opinion does not always reflect the reality? Are they less cautious than younger participants which may effect their evaluation? Or their evaluation comes from more experienced people, so it is more reliable? These questions are hard to answer with the collected data, however, further research may be of importance to cover such issues.

8.4. SUMMARY

The main objective of this study was to evaluate the effectiveness of corporate governance in Saudi joint stock corporations by comparing actual practices with best practices. The other objective was to identify whether there are significant differences between the four selected samples, namely: board of directors members; chief executive officers; audit committee members; and shareholders, towards the four mechanisms of corporate governance, namely: the rights of shareholders; board of directors; audit committee members and internal audit; and disclosure and transparency.

These objectives were achieved in this chapter by providing some confirmatory (inferential) data analysis that goes beyond mere description of the data collected and ends up with inferences regarding the hypotheses for which the sample data were obtained. ANOVA tests were run to determine whether the differences observed in the mean scales of the four categories of participants (board of directors' members, chief executive officers, audit committee members and shareholders) – with respect to the four mechanisms of corporate governance (Shareholder rights, board of directors, audit committees and internal audit and disclosure and transparency) – were statistically significant or not in Saudi joint stock corporations.

The Analysis of Variance (ANOVA) was carried out to investigate whether there were differences between the four samples towards the evaluation of the effectiveness of corporate governance in Saudi Arabia. It had the distinct advantage of being applicable when more than two means were being compared. Usually when rejecting the null hypothesis, the exact areas of differences need to be exactly pinpointed. To do this, multiple comparison procedures, the Scheffe test, were followed.

Finally tests of the differences in the means and variances (heterogeneity and homogeneity of variance) between responses to the corporate governance data with respect to the demographic questions were run to investigate whether there were significant differences between means of different characteristics of board members, chief executive officers, audit committee members and shareholders such as educational qualification, experience and age.

CHAPTER NINE:

CONCLUSION AND RECOMMENDATIONS

9.1. INTRODUCTION

It has been seen that corporate governance has been a major policy of concern for many developed and developing countries following the financial crises in Asia, Russia and America. The collapse of Enron suggests that even highly industrialized countries such as the U.S.A. are not immune from the destruction caused by bad corporate governance. Studies have shown that poor corporate governance standards raise cost of capital, lower operating performance of industry and impede the flow of investment (Daily et al., 1992; Agrawal et al., 1996; Himmelberg et al., 2001). Regulators in many countries have embarked on plans to strengthen the protection of the interests of investors through the revision or amendment of laws or regulations on corporate governance.

The objectives of this chapter are threefold: first, to provide a summary of the proceeding chapters together with an overview to the principal findings of the study; second, to provide some recommendations to improve corporate governance practices in the Saudi corporate sector based on the findings of this study and on the lessons learned from the experiences of other countries; and third, to provide suggestions for future research to develop the issue of corporate governance in Saudi Arabia and to improve the effectiveness of corporate governance in Saudi joint stock corporations.

9.2. THESIS OVERVIEW

The primary objectives of this study were to explore and investigate the effectiveness of corporate governance in Saudi joint stock corporations and to explore whether there are differences in the perceptions of the four selected samples comprising of board of directors members, chief executive officers, audit committee members and shareholders. There was also an aim to examine whether the agreement between each respective sample towards specific statements is significant or not.

The introductory chapter provided a brief summary to the background, justification, objectives, research methodology and limitations of the study. Chapter 2 provided an overview of corporate governance. The chapter commenced by providing the following definition to corporate governance.

> Corporate governance refers to that blend of law, regulation, and appropriate voluntary private-sector practices that enable the corporation to attract financial and human capital, perform efficiently, and thereby perpetuate itself by generating long-term economic value for its shareholders, while respecting the interests of stakeholders and society as a whole (Gregory, 2001: pp. i).

It is then emphasised that the corporate failures in Asia, Russia and the U.S.A., amongst others, have shown that a lack of regard for core values of corporate governance does have a negative impact globally. Markets and companies that have not been able to survive or that have fared badly in a crisis have one thing in common: poor corporate governance standards (Keong, 2002). To illustrate the trend of corporate governance has been in the last two decades, six countries (the United States of America, United Kingdom, France, Germany, Korea and Malaysia) have been investigated in order to benefit from those countries in the development of the Saudi's corporate governance rules and codes of good governance practice.

In Chapter 3, it was pointed out that corporate governance in a particular country reflects its history, culture, regulatory structures and capital market characteristics (Keong, 2002). Therefore, when studying corporate governance in Saudi Arabia, it is obviously essential to consider the country's history, culture, regulatory structures, economy, capital market characteristics, etc. The Saudi constitution was introduced in this chapter, which was the Qur`an and the Sunnah, the teachings and deeds, of the prophet Mohammed, God's prayers and peace be upon him. It was then mentioned that the Saudi government, through five-year development plans, has sought to allocate its petroleum income to transform its relatively undeveloped, oil-based economy into that of a modern industrial state while maintaining the kingdom's traditional Islamic values and customs. The major elements and characteristics of these plans were discussed and an outlook to the Saudi economy and to the financial system and its major components was presented. A modern financial system plays an important role in allocating resources in a productive manner.

The question of 'who regulates corporate governance in Saudi Arabia' was also investigated. Corporate governance practices in Saudi Arabia are governed by four bodies: the Ministry of Commerce, the Saudi Arabian Monetary Agency (SAMA), the Saudi Stock Exchange (Tadawul) and some professional bodies. A general outlook into the adoption of the four mechanisms of corporate governance (shareholder rights, board of directors, audit committee and internal audit and disclosure and transparency) in Saudi Arabia was then presented.

In the final section, an issue that has not been explored to a great extent in the literature, the influence of religion upon corporate governance, was investigated. The government laws and regulations in Saudi Arabia must be submitted to the *Shari'ah* (Islamic laws) and *Sunnah.* Two aspects, in particular, shape the relationship between Islam and corporate governance. One is the Islamic law, *the shari'ah*, and the other is the Islamic jurisprudence, *the fiqh.*

In Chapter 4, it was argued that the assessment of corporate governance is the outcome of the assessment of the four corporate governance legs (mechanisms), namely: shareholders' rights; board of directors; audit committees and internal audit; and disclosure and transparency. The intensity of adoption of these mechanisms in the Saudi publicly traded (joint stock) corporations was tested. Therefore, the author described and developed these mechanisms and the rules of practising each mechanism of effective corporate governance to come up with how these mechanisms should be followed and practised in Saudi joint stock corporations.

In Chapter 5, the four guiding mechanisms of corporate governance (shareholders' rights, board of directors, audit committee and internal audit and disclosure and transparency) were identified and promoted as the benchmarks for best practices of corporate governance in Saudi Arabia to which companies should aspire with paying a special attention to the influence of religion (Islam) and culture upon those principles. The related literature was investigated followed by an introduction to the underlying theories: the no-one-size-fits-all theory and the agency theory. The hypotheses involved with this research were then introduced.

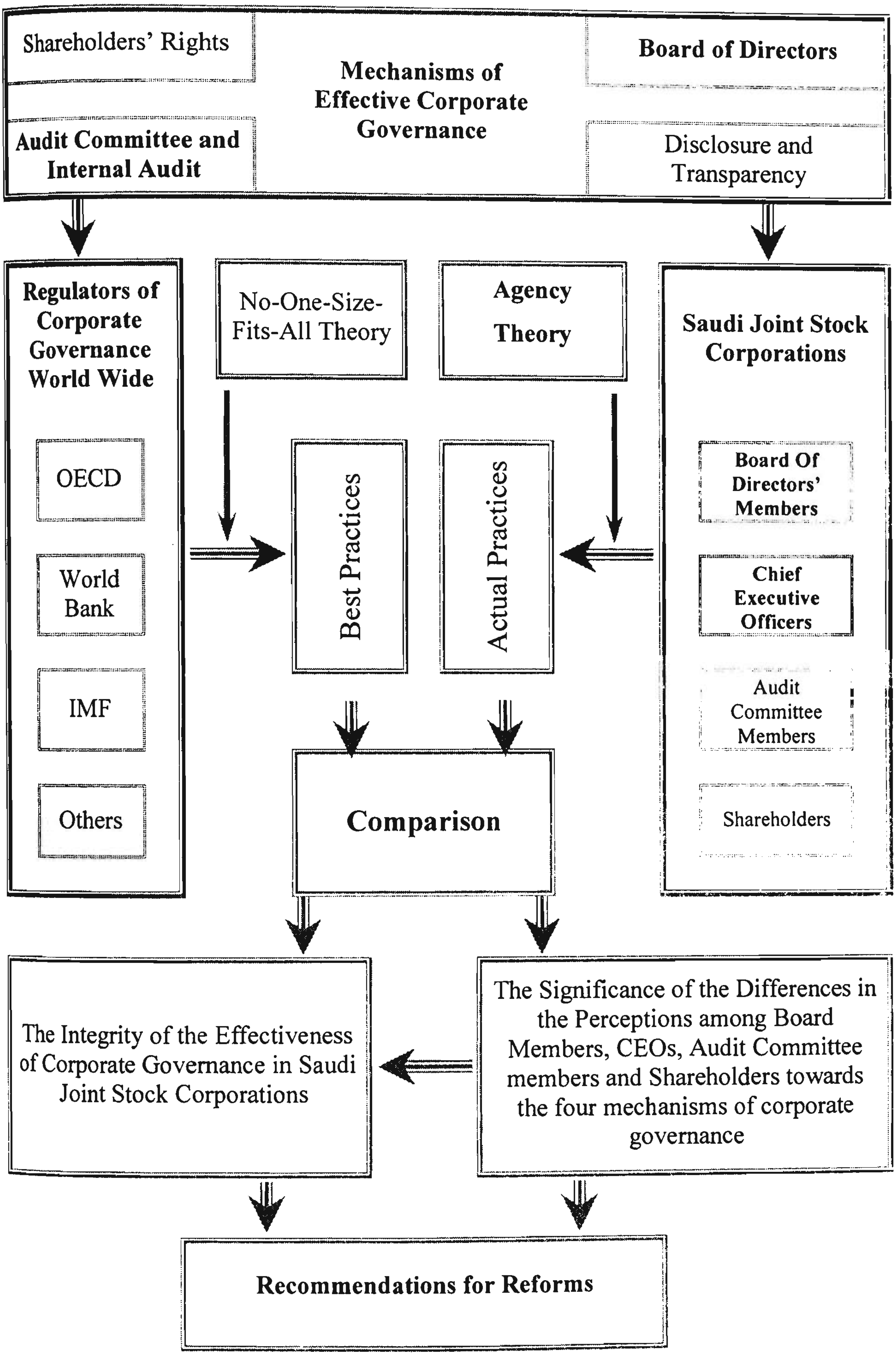
In Chapter 6, the research approach adopted in this thesis, mail-out survey questionnaire, was explained. It was started by reviewing the main aims of this project. In the process of the construction of the methodology, various factors that best reflect corporate governance standards in Saudi Arabia were considered. The choice of the variables and statements in the questionnaire was based on the four mechanisms of corporate governance discussed in the previous chapters. The discussion was then divided into six major sub-sections, each of which discussed a different major step in administering the survey methodology used in this thesis.

In Chapter 7 and 8, the results of the study were presented. In Chapter 7, a descriptive data analysis, that was concerned with summarizing and presenting the data in tables, charts and other diagrammatic forms that enabled patterns and relationships to be discerned which are not apparent in the raw data, was presented. In Chapter 8, a confirmatory data analysis, that went beyond mere description of the collected data and tried to provide inferences regarding the effectiveness of corporate governance in Saudi joint stock corporations, was presented. The major findings of these two chapters could be summarized in the following section.

9.3. MAJOR FINDINGS

Figure 9.1 presents the model of the research that was introduced in Chapter 5. Figure 9.1 shows that a compassion between the best practices and the actual practices has been done to test the underlying hypotheses as well as to evaluate the integrity of the effectiveness of corporate governance practices in Saudi joint stock corporations. In regards to the integrity of the effectiveness of the four mechanisms of corporate governance in Saudi joint stock corporations, the following paragraphs will summarize the major findings of each mechanism. A summary of the results of the hypotheses testing follows that.

Figure 9.1. Research Model



The Saudi joint stock corporations generally were found to be doing relatively well in allowing shareholders to participate effectively in general meetings and decision-making process and to exercise other shareholders' rights such as secure registration and sharing in profits. Minority shareholders, however, seem to encounter difficulties in calling special shareholders' meetings, putting issues on meeting agendas and obtaining timely information. They were also inadequately protected with such rights as priority subscription, approval of major related-party transactions, and dissenters' rights and they take little part in the process of selecting directors.

The size and composition of boards varied widely among the Saudi joint stock corporations. The independence of independent directors was questionable. The factors most responsible for such lack of independence were related to the low mean values obtained to the following statements: there are at least three non-executive members in the board; shareholders elect members of the board; board members were not affiliated with a significant customer or supplier; and the roles of the chief executive officer and the chairman of the board of directors are separated. The CEO or controlling owner seemed to be the one who selects directors rather than shareholders. The boards were generally weak in performing some of their functions, particularly those pertaining to selecting, monitoring and replacing the CEO and reviewing the remuneration of key executives and directors, and they tend not to have independent board committee for remuneration and independent board committee for nomination. They appear to be particularly poor in evaluating directors' performance and supporting outside directors with access to information, education and training and incentive compensation and poor in ensuring compliance with applicable law and take into account the interests of stakeholders.

Although the existence of an audit committee was mandatory in all listed Saudi corporations, the number of members in those committees was less than four, which is a violation to Article 2-1 of the Project of Regulating Audit Committees in the Saudi Joint Stock Companies issued by the Saudi Organization for Certified Public Accountants, which states that there must be at least four members in the audit committee (SOCPA, 2003). Virtually all the audit committees in Saudi joint stock corporations had accounting or finance specialists; are chaired by an independent director; take minutes of committee meetings; and had written rules governing the overall audit function. Weak statements were the following: the audit committee approves the appointment and replacement of the internal audit head and discusses with him related matters; report on audit committee's activities provided at annual shareholder meeting; and audit committee has access to relevant information.

Sample firms performed relatively poorly in the areas of information disclosure and transparency, particularly in relation to matters such as disclosing material foreseeable risk factors, providing channels for disseminating information provide for fair, timely and cost-efficient access to relevant information by users, disclosing governance structures, disclosing the remuneration of the board members and disclosing the financial and operating results of the company in English language. Firms were not yet making full use of web sites to disclose information in a timely fashion and to enhance transparency. While disclosure is a legal requirement and, in general, companies do adhere to the rule, the question remains whether the Saudi Capital Market Authority insures high information quality and whether investors are keen to use the information for better investment decisions. Improving the quality of information is a challenge in Saudi Arabia, which consequently suffers from poor risk assessment strategies. Due to a lack of awareness in the Saudi private sector and the lack of functioning mechanisms to detect and deter insider information, insider trading was found to be a serious problem. A need, therefore, for a further research in this area and in insider trading in particular is urgent.

The major findings of chapter 7 were that the mean values of the first two samples, board of directors (Table 7-20) and chief executive officers (Table 7-21), were higher than the mean values of the last two samples, audit committee members (Table 7-22) and shareholders (Table 7-23). That was a clear indication that the board of directors' members and the chief executive officers were more confident about the effectiveness of corporate governance in Saudi joint stock corporations than the audit committee members and the shareholders (the board of directors and the chief executive officers have been highlighted in Table 9-1). This finding may be related to the existence of the agency problems which may have lead to a significant difference between the perceptions of the first two samples and the last two samples. Enhancing shareholder confidence is a key element in effective corporate governance and a key element in reducing the agency problems. Effective corporate governance depends on the extent to which corporations meet shareholders' expectations. The results of this study, however, indicated that there was a partial failure to meeting the shareholders' expectations since it was clear from Table 7-23 that shareholders were less confident about their rights and about the effectiveness of corporate governance in the Saudi joint stock corporations. This shortage in shareholders' confidence occurred because of flawed corporate governance processes in Saudi joint stock corporations and the core of the problem is a breach of fiduciary duty by the trustees of the investors' interests: the board of directors and management.

The focus of the eighth chapter was on using statistical analysis to determine whether the observed differences between the four samples (board of directors' members, chief executive officers, audit committee members and shareholders) are due to random chance (as stated in the null hypotheses) or to true differences in the samples (as stated in the alternate hypotheses). The null hypotheses stated that the differences observed in the mean scales of the participants (board of directors' members, chief executive officers, audit committee members and shareholders) – with respect to each of the four mechanisms of corporate governance (shareholders' rights, board of directors, audit committee and internal audit and disclosure and transparency) – are statistically insignificant in Saudi joint stock corporations. The decisions made regarding the tested hypotheses are summarized in the following Table (9-1).

Table 9-1 Summary to the Decisions Regarding the Null Hypotheses

Mechanisms of Corporate Governance	Null Hypotheses	Alternative Hypotheses	Decisions
Shareholders' Rights	$H_{0\,SHR}$: $\mu_{board} = \mu_{ceo} = \mu_{audit} = \mu_{share}$	$H_{1\,SHR}$: $\mu_{board} \neq \mu_{ceo} \neq \mu_{audit} \neq \mu_{share}$	Rejected
Board of Directors	$H_{0\,BD}$: $\mu_{board} = \mu_{ceo} = \mu_{audit} = \mu_{share}$	$H_{1\,BD}$: $\mu_{board} \neq \mu_{ceo} \neq \mu_{audit} \neq \mu_{share}$	Rejected
Audit Committee and Internal Audit	$H_{0\,AC}$: $\mu_{board} = \mu_{ceo} = \mu_{audit} = \bar{x}_{share}$	$H_{1\,AC}$: $\mu_{board} \neq \mu_{ceo} \neq \mu_{audit} \neq \mu_{share}$	Not Rejected
Disclosure and Transparency	$H_{0\,D\&T}$: $\mu_{board} = \mu_{ceo} = \mu_{audit} = \mu_{share}$	$H_{1\,D\&T}$: $\mu_{board} \neq \mu_{ceo} \neq \mu_{audit} \neq \mu_{share}$	Rejected

Note

μ_{board}	Mean of sample1 (board of directors)
μ_{ceo}	Mean of sample2 (chief executive officers)
μ_{audit}	Mean of sample3 (audit committee members)
μ_{share}	Mean of sample4 (shareholders)
$H_{0\,SHR}$	Null hypothesis in respect to shareholders rights
$H_{1\,SHR}$	Alternative hypothesis in respect to shareholders rights
$H_{0\,BD}$	Null hypothesis in respect to board of directors
$H_{1\,BD}$	Alternative hypothesis in respect to board of directors
$H_{0\,AC}$	Null hypothesis in respect to Audit Committees and Internal Audit
$H_{1\,AC}$	Alternative hypothesis in respect to Audit Committees and Internal Audit
$H_{0\,D\&T}$	Null hypothesis in respect to disclosure and transparency
$H_{1\,D\&T}$	Alternative hypothesis in respect to disclosure and transparency

Although cultural, political, economic and religious norms influence the way in which Saudi Arabia approaches corporate governance and its impact on board leadership, management oversight and accountability, the challenge for the Saudi corporate governance regulators is to reach an appropriate balance of legislative and regulatory reform, taking into consideration international best practice to promote enterprise, enhance competitiveness and stimulate investment.

Corporate governance reforms should begin with a clear definition of the authority, duties, and accountability of the board of directors and management. Although implementing corporate governance best practices would result in additional operating costs, it should be emphasized that good corporate governance is not an option but an obligation for Saudi Arabia at the current time, if shareholder interest is to be protected.

9.4. RECOMMENDATIONS

To sum up, corporate governance encompasses rules and market practices which determine how companies make decisions, the transparency of their decision-making processes, the accountability of their directors, managers and employees, the information they disclose to investors and the protection of minority shareholders. It involves issues of company law, securities laws, the listing rules of a country's stock exchanges, accounting standards applicable to listed companies, competition or anti-trust laws and bankruptcy or insolvency laws. It includes the government regulations and regulatory agencies with which corporations and shareholders deal and those regulators' actions to ensure compliance with applicable laws and regulations. Corporate governance involves the courts as well, since shareholders, directors, managers and regulators call upon courts to resolve corporate governance disputes and enforce government regulations. Thus a number of entities need reform and changes in the Saudi economy.

9.4.1. Lessons Learned from the Experiences of other Countries

As it has been seen from the countries investigated (Chapter 2) that since the mid 1990s the corporate governance movement grew into a major movement world wide, spreading from the US, over the UK to the rest of the world (Carlsson, 2001;

Keong, 2002; and Charkham, 1995). Despite the diversity in corporate governance between the United States, United Kingdom, France, Germany, Korea and Malaysia, it has been noticed that all of them are undertaking corporate governance reforms. This emphasizes the strong trend in changing laws and regulations or/and setting best practices of corporate governance. The goal is to have strong and independent boards of directors, responsible management, enhanced shareholder rights and activism, transparent financial disclosure, tighter control of insider trading and self-dealing transactions, greater accountability of controlling shareholders, directors and stronger regulatory environment.

It has also been seen that countries around the world are characterized by alternative corporate governance systems (Shleifer et al. 1997). Considerable debate is going on illustrating how good, superior or effective these systems are. Prowse (1995) suggested that such judgments are inherently subjective because of the sparse evidence on the relative performance of different corporate governance systems.

Globalization has posed both challenges and opportunities to corporate governance reforms in both developed and developing countries. On one hand, globalization can accelerate the convergence of corporate governance to international standards (Khanna, et al. 2001). On the other hand, however, globalization has increased the competition for some inefficient domestic firms and thus created high pressure for them to survive. Saudi Arabia's financial system has been a part of the globalization process from its very beginning as evidenced by the presence of many financial institutions from both developed and developing countries.

The idea that one system of corporate governance might serve as a model for the whole world is an idea that has not been well received of late. The past ten years have witnessed remarkable shifts in enthusiasm for and against alternative corporate governance systems. It has become fashionable in the last five years to attribute almost everything that happens to the processes of globalization. The growth of international trade and investment made it administratively impossible to maintain foreign exchange controls (Dore 2000). Therefore, a need for a global corporate governance system is a fact that should be considered by all corporate governance organizations world-wide.

Corporate integrity, strengthened market discipline, increased transparency through improved disclosure, effective regulation and corporate accountability are common principles that are the foundations for sound international corporate governance.

The Organisation for Economic Cooperation and Development (OECD) advisory group (2004) concludes that "the practical corporate governance agenda in different countries is converging in many vital areas, although historical and cultural differences will continue to exist" (OECD 1998a: pp. 87).

Saudi Arabia has been actively participating in all international groups that are concerned with the safety and soundness of effective corporate governance. It is well represented in international organizations and fora such as IMF, World Bank, BIS, Basle Committee on Banking Supervision and the OECD. The Saudi authorities have emphasized the notion of strong corporate governance in which the directors of joint stock corporations are expected to play an important oversight role and demonstrate high levels of personal responsibility and integrity. Saudi Arabia has also taken the lead in guiding Saudi joint stock corporations to adopt international accounting standards and meet the most rigorous transparency and disclosure requirements.

9.4.2. Recommendation for Corporate Governance in Saudi Arabia

Based upon the assessment in this thesis of corporate governance in Saudi Arabia, which benchmarks the Saudi Arabian situation relative to the principles of corporate governance developed by a number of organizations (e.g., the United Nations Development Programme 'UNDP'; the Organisation for Economic Cooperation and Development 'OECD'; the World Bank; the International Monetary Funds 'IMF'; the International Corporate Governance Network 'ICGN'; and others), the following recommendations are suggested for various regulatory authorities in Saudi Arabia.

9.4.2.1. Code of Corporate Governance

- In view of the objectives of this thesis, in order to enhance the effectiveness of corporate governance in Saudi Arabia, regulatory authorities of corporate governance in Saudi Arabia are urgently encouraged to set up Codes of Best Practice for Corporate Governance in Saudi Arabia that suit their cultural, religious, and environmental needs;

- the proposed Code for Saudi should be simple, practical, easily implemented and enforceable; and
- the regulatory authorities in Saudi Arabia such as the Ministry of Commerce, the General Auditing Bureau, the Saudi Arabian Monetary Agency, the Saudi Organization for Certified Public Accountants, the Saudi Stock Exchange Commission and the Saudi Stock Exchange (Tadawul) should all participate in setting the Code.

9.4.2.2. Saudi Stock Exchange '*Tadawul*'

- Even if corporate governance needs time to be embedded in the Saudi system, Tadawul should, in the interim, change its listing rules to differentiate between issuers that adhere to good corporate governance practices and others who do not;
- the Saudi Stock Exchange Commission should have the right enforcement tools to make sure that information disclosure is timely and available to all shareholders at the same time. Thus, good issuers must be rewarded and those who choose not to compliant should be penalized;
- listed companies should be required to disclose governance practices in the annual report and the degree of compliance with corporate governance rules; and
- Tadawul should exercise the right to de-list companies that do not conform to the code.

9.4.2.3. Regulatory Authorities

- Independent oversight body - The Saudi Stock Exchange Commission should be one of the main driving forces towards establishing a" Corporate Governance Institute" in Saudi Arabia;
- Saudi should aggressively pursue the adoption and implementation of global standards, principles and practices aimed at strengthening the financial system;
- Saudi should aggressively move to have and to maintain an open and liberal financial market with minimal restrictions on free flow of capital and to have a strong and healthy banking system to maintain sustainable economic growth; and

- regulatory enforcement of standards and laws needs to be considerably strengthened in Saudi Arabia.

9.4.2.4. Shareholders' Rights

- Protection of minority shareholders' rights should be given high priority;
- shareholders must carry the responsibility of electing the board members;
- shareholders should be encouraged to participate in general meetings' discussion and to ask questions of the board members;
- enhancing shareholder activism in general annual meetings;
- insider trading and abusive self-dealing must be completely prohibited;
- providing educational publications/seminars/advertisements to the public at large as well as shareholders on how to become active shareholders; and
- educating minority shareholders about their rights and the importance of interacting with their companies.

9.4.2.5. Board of Directors

- Strengthen the role and effectiveness of shareholders' meetings;
- training and educational seminars to directors, management, auditors and other employees of listed joint stock corporations about the importance and adherence to corporate governance;
- ensuring that independent directors reflect minority shareholders' opinions and protect their interests;
- enhancing the participation of minority shareholders in the selection of independent directors;
- allow for postal voting;
- establish mandatory remuneration and nomination committees;
- ensuring that board members do not provide consultation to their company and are not affiliated with a company that is an adviser or consultant to the company or senior management; and
- ensuring that there are at least three non-executive directors in the board.

9.4.2.6. Audit Committees

- Developing training programs for audit committee members and internal auditors;
- strengthening audit practices of internal and external audit members by providing training programs to auditors by the Saudi Organization for Certified Public Accountants;
- audit committees should be authorized to approve the appointment and replacement of the internal audit head and discusses with him related matters;
- there must always be four members in the audit committees;
- clearly defining what kind of information must be contained in the report on audit committee's activities provided at annual shareholder meeting;
- supporting the creation of a professional body with the authority to impose codes of corporate governance and monitor the implementation of such codes;
- Religious auditing must be enforced so organizations comply with the Shari'ah.

9.4.2.7. Disclosure and Transparency

- Reform in corporate transparency should not be delayed. Quarterly reporting and more timely disclosure requirements are important measures in this area;
- companies should be encouraged to disclose financial and operating results in English;
- disclosing material of foreseeable risk factors and governance structures; and
- channels for disseminating information provide for fair, timely and cost-efficient access to relevant information by users should be enhanced.
- Any violation of the Islamic principles in the operation of organization should be reported by the religious auditors in the organization's financial statement as in the case of external auditor reporting their opinion on the true and fair view of the organization's financial position.

9.4.2.8. General

- Promoting, as an absolute priority, good governance, democracy, the rule of law and an independent judiciary, otherwise efforts in other domains to reach lasting development will prove futile;

- reforms must fit within the country's existing laws and institutions and cannot just be imported from other countries;
- Saudi should start from the end of what have been reached by other countries and learn from them;
- since Saudi Arabia recognizes that foreign capital has an important role to play in accelerating economic growth[1], Saudi should assure prospective international investors that they will find equivalent standards of corporate governance, as prevalent elsewhere; and
- while establishing sound corporate governance systems, efforts to enhance business ethics are also indispensable. No matter how coherent, detailed and meticulous the law or system is designed, its actual implementation rests with the people. Therefore, the initiative to abide by the rules and regulations, to observe the principles behind and to maintain high ethical standards are all too significant for good corporate governance. Persistent effort by regulatory authorities, organizations of different sectors and enterprises to promote business ethics can never be spared.

9.5. FUTURE RESEARCH

Given the shortage in the literature on the effectiveness of corporate governance in Saudi Arabia, since this is the first empirical study to investigate corporate governance in Saudi Arabia, and given the infancy of our efforts to understand corporate governance and assess its effectiveness in this country, it seems sensible to ask for more research in this area. Better understanding and clarification of corporate governance is important. Recommendations to enhance the adoption and the implementation of corporate governance practices in Saudi Arabia should be provided. Therefore, further research in corporate governance is of high priority.

The concentration in the present thesis was on four mechanisms of corporate governance, namely: shareholders' rights; board of directors; audit committee and internal audit; and disclosure and transparency (Figure 9.1). The effectiveness of these mechanisms has been tested in Saudi joint stock corporations. Further research on other mechanisms of corporate governance such as stakeholders, management, etc.

[1] A new investment law was enacted in 2000, paving the way for foreign firms to make direct investment in most of the country's economic sectors with or without domestic participation.

would be helpful. Also, more investigation of different sectors in Saudi Arabia will add better understanding to the strengths and weaknesses of corporate governance in those sectors to develop comprehensive knowledge about the effectiveness of corporate governance in Saudi Arabia.

There are successful family owned or controlled companies in Saudi Arabia. More empirical research on the merits and demerits of corporate governance and how has it impacted firm value would be valuable. How corporate governance may evolve in these companies and what can be done to better align the interest of controlling family ownership and other shareholders?

Furthermore, the complexity of globalization certainly invites additional research. We are in great need of further theoretical work to clarify how corporate governance affects competitiveness. We also need better data on more developing countries, especially those with poor governance. We need to engage in comparative work in the dual sense of using multiple methods of data collection and analysis, and of applying our theoretical and empirical tools to a variety of research settings defined at various levels of analysis (Smelser 1976; Smelser and Swedberg 1994; Tilly 1984). The differences and similarities across such settings ought to give us insight on the patterns according to which the effectiveness of corporate governance change from one setting to another.

Finally, another recommended avenue for future research would be to dig deeper into companies to isolate the root causes of the governance failures that were mentioned in the analysis chapters. Hence, interviews and empirical studies are strongly recommended to be conducted into areas such as the extent of insider trading.

APPENDICES

APPENDIX I

QUESTIONNAIRE MATERIAL

(English Versions)

VICTORIA UNIVERSITY
A NEW SCHOOL OF THOUGHT

School of Accounting and Finance

Dear Participants,

I request your kind support by responding to this survey which is part of my Doctor of Philosophy (Ph.D) degree's research project, at Victoria University, in Melbourne, Australia.

The research project being undertaken seeks to assess corporate governance in Saudi Arabia. To ensure the validity of results, a reply to the attached questionnaire would be greatly appreciated.

While your cooperation in completing the questionnaire is valued, your participation is voluntary. The results will be used only in an aggregated form and therefore your anonymity and the confidentiality of your responses are assured. The completed questionnaire will be securely stored and available only to the supervisors and myself. The only people to have access to the details of the questionnaires are my supervisors, external examiners, Victoria University and myself.

The results in an aggregate form will be contained in the thesis which will be available at the Victoria University of Technology library. It is also hoped that aspects of the results will be published in aggregate in various professional and academic journals.

Your participation would be appreciated and I look forward to receiving your complete questionnaire by the end of (   ). Please return the questionnaire fully completed without your name on it, in the enclosed pre-stamped envelop, within 21 days of receiving it to the following address:

P. O. Box 1666 Al-Bokairiah
Al-Qassim, 51941
Kingdom of Saudi Arabia

Thank you in anticipation of your cooperation.

Yours truly,

Khalid Al-turki

Should you have any queries regarding the project or questionnaire, please feel free to contact me on (0555132301) or e-mail me at: saudiphd@hotmail.com or my senior supervisor, Professor Robert Clift, on e-mail: bob.clift@vu.edu.au, or you may contact the Chairman, University Human Research Ethics Committee, Faculty of Business and Law, Victoria University of Technology, P.O. Box 14428 MCMC, Melbourne, 8001 (e-mail: nick.billington@vu.edu.au).

King Saud University جامعة الملك سعود

Dear Sir,

Khalid Al-turki is one of our lecturers at King Saud University, and he is doing his Doctor of Philosophy PhD research project at Victoria University in Australia.

We kindly request your support by responding to this survey which is part of Khalid's Ph.D degree research project at Victoria University in Melbourne, Australia.

This letter is to emphasise that the survey results will be confidential to Khalid, his supervisors, the external examiners and Victoria University.

Any questions in this regard could be directed to myself at the Department of Accounting at King Saud University.

Sincerely yours,

(Dr) Obaid Al-motairy
Head of Accounting Department
King Saud University
o.almotairy@hotmail.com
(06) 380-0050 ext.1026-1028

Section 1: The General Questions

The following questions are general questions. Please tick one box or more in every question as appropriate.

1.1. What is your category of respondent?

	Shareholder		Audit committee member
	Board member		Chief executive officer

1.2. In which industry is your company involved?

	Banking		Electrical		Agriculture
	Services		Telecom		Cement
	Industrial				

1.3. In which of the following age groups do you belong?

	Under 25		26-35		36-45
	46-55		56-65		Over 66

1.4. Please indicate the highest level of education achieved

	Under High School		High School
	Bachelor		Master
	Doctoral		Other

1.5. Where did you achieve the highest level of education?

	Saudi Arabia		U.S.A.		U.K.
	Australia		Other		

1.6. What was your major (field of specialization)?

....

1.7. How many years have you worked in your current position?

	5 years or less		6-10		11-15
	16-20		21-25		26 or more

1.8. If you are a shareholder, how many shares do you own?

	Less than 500		500-999		1000-1999
	2000-4999		5000-9999		10000 or more

Section 2: The Corporate Governance Questions

2.1. Shareholder Rights

The following set of statements deal with your attitudes towards some issues, which relate to whether the shareholders in your company get their rights or not according to the actual practice NOT best practice. Please indicate explicitly your agreement or disagreement with each of the following statements by ticking the appropriate box: not at all, slightly, moderately, significantly and extremely. For example, if you strongly agree with a specific statement please tick the box under 'Extremely'; if you strongly disagree with a specific statement please tick the box under 'Not at All'; and so on.

Statements	Not at all	Slightly	Moderately	Significantly	Extremely
Shareholders have secure methods of ownership registration					
Shareholders are able to practise their rights					
Shareholders obtain timely and regular information on the corporation					
Shareholders understand their rights					
Shareholders care about attending general meetings					
Shareholders are furnished with sufficient and timely information concerning general meetings (date, location and agenda)					
Shareholders participate in the general meeting discussion and ask questions to the board members					
Shareholders vote in general meetings and place items on the agenda					
Shareholders share in the profits of the corporation					
Shareholders elect members of the board					
All shareholders of the same class are treated equally					
Within any class, all shareholders have the same voting rights					
Procedures for general meetings allow for equitable treatment of all shareholders					
Insider trading and abusive self-dealing are prohibited					
Generally, shareholders get their rights					

2.2. Board of Directors

The following set of statements deal with your attitudes towards some issues, which relate to the effectiveness of the board of directors and the outside directors in your company according to the actual practice NOT best practice. Please indicate explicitly your agreement or disagreement with each of the following statements by ticking the appropriate box: not at all, slightly, moderately, significantly and extremely. For example, if you strongly agree with a specific statement please tick the box under 'Extremely'; if you strongly disagree with a specific statement please tick the box under 'Not at All'; and so on.

Statements		Not at all	Slightly	Moderately	Significantly	Extremely
The board of directors monitors the management						
The board members act on a fully informed basis, in good faith, with due diligence and care, and in the best interest of the company and the shareholders						
The board treats all shareholders fairly and equally						
There are at least three non-executive members in the board						
The board ensures compliance with applicable law and take into account the interests of stakeholders						
The board members fulfil their expected key functions including	Reviewing and guiding corporate strategy					
	Setting performance objectives					
	Overseeing the process of disclosure and communications					
	Ensuring the integrity of the corporation's accounting and financial reporting systems					
Board members do not provide consultation to their company and are not affiliated with a company that is an adviser or consultant to the company or senior management						
Board members are not affiliated with a significant customer or supplier						
There is an independent board committee for remuneration						
There is an independent board committee for nomination						
There is an independent board committee for auditing						
The roles of the chief executive officer and the chairman of the board of directors are separated						
The board members devote sufficient time to their responsibilities and attend at least 75% of meetings, on average.						
The firm holds four or more regular board meetings per year						
The board members have access to accurate, relevant and timely information						
Generally, the board of directors is effective						

2.3. Audit Committee and Internal Audit

The following set of statements deal with your attitudes towards some issues, which relate to the effectiveness of the audit committee and the internal audit in your company according to the actual practice NOT best practice. Please indicate explicitly your agreement or disagreement with each of the following statements by ticking the appropriate box: not at all, slightly, moderately, significantly and extremely. For example, if you strongly agree with a specific statement please tick the box under 'Extremely'; if you strongly disagree with a specific statement please tick the box under 'Not at All'; and so on.

Statements	Not at all	Slightly	Moderately	Significantly	Extremely
Audit committee exists and is independent from management					
The audit committee monitor and review the effectiveness of the company's internal audit function					
The audit committee approves the appointment and replacement of the internal audit head and discusses with him related matters					
The audit committee makes recommendations to the board in relation to the appointment of the external auditor, his remuneration and terms of engagement					
The audit committee reviews and monitors the integrity of the financial statements of the company before they are approved by the board of directors and publicly disseminated to ensure their objectiveness, accuracy, and timeliness					
There are at least four members in the audit committee					
Audit committee includes someone with expertise in accounting and auditing					
The committee members understand the audit committee functions					
Audit committee meets at least four times a year					
Audit committee member attend at least 75% of meetings, on average					
Agenda and related material are provided to members ahead of meetings					
Report on audit committee's activities provided at annual shareholder meeting					
Audit committee has access to relevant information					
Objectives, responsibilities and authority of the audit committee are clearly defined in a written statement (charter)					
Generally, the audit committee is effective					

2.4. Disclosure and Transparency

The following set of statements deal with your attitudes towards some issues, which relate to the effectiveness of the disclosure and the transparency in your company according to the actual practice NOT best practice. Please indicate explicitly your agreement or disagreement with each of the following statements by ticking the appropriate box: not at all, slightly, moderately, significantly and extremely. For example, if you strongly agree with a specific statement please tick the box under 'Extremely'; if you strongly disagree with a specific statement please tick the box under 'Not at All'; and so on.

Statements	Not at all	Slightly	Moderately	Significantly	Extremely
Disclosure and transparency are of high priority in the company					
The company discloses the company's objectives and policies					
The company discloses the financial statements and information in the newspaper					
The company has a website in the Internet					
The company discloses the financial and operating results of the company in Arabic					
The company discloses the financial and operating results of the company in English					
The company discloses major share ownership and voting rights					
The company discloses members of the board and key executives					
The company discloses the remuneration of the board members					
The company discloses material foreseeable risk factors					
The company discloses material issues regarding employees and other stakeholders					
The company discloses governance structures					
The company's information is prepared, audited and disclosed in accordance with the standards of accounting, financial and non-financial disclosure accepted by the Saudi Government					
Channels for disseminating information provide for fair, timely and cost-efficient access to relevant information by users					
Generally, the firm's disclosure and transparency are effective					

The questions finished.

Please return the questionnaire fully completed without your name on it, in the enclosed pre-stamped envelop, within 21 days of receiving it to the following address:

P. O. Box 1666, Al-Bokairiah
Al-Qassim, 51941
Kingdom of Saudi Arabia

The questionnaire could also be faxed to this fax number: 06 380 0565

Thank you again in anticipation of your cooperation.

Yours truly,

Khalid Al-turki

APPENDIX II

QUESTIONNAIRE MATERIAL

(Arabic Versions)

VICTORIA UNIVERSITY | A NEW SCHOOL OF THOUGHT

School of Accounting and Finance

سعادة الأخ المشارك،

السلام عليكم ورحمة الله وبركاتة وبعد

فاني أحد طلاب الدكتوراه في جامعة فكتوريا في مدينة ملبورن باستراليا والمبتعثين من جامعة الملك سعود – فرع القصيم – قسم المحاسبة.

موضوع رسالتي للدكتوراه هو عن موضوع ال corporate governance في الشركات المساهمة في المملكة العربية السعودية. هذا الموضوع هو محط أنظار الباحثين والاقتصاديين في الاونة الأخيرة لما له من اهمية في تفعيل نظام الرقابة على الشركات والذي لم يلتفت اليه الباحثون الى بعد انهيار عدد من الشركات العالمية الكبرى مثل شركة Enron للطاقة الأميريكية. للأسف فان الباحثون العرب المهتمون بهذا المصطلح لم يتوصلوا بعد الى تعريب دقيق له، ولكن باعتقادي أن تطبيق المفاهيم التي خلف هذا المصطلح هي أجدر بالاهتمام على الأقل في الوقت الحالي لكي يتم تطبيقها على السوق الاقتصادي في المملكة العربية السعودية ومن ثم تفعيل وتطوير نظام الرقابة على الشركات في المملكة ولعل دوري الان يقتصر على الشركات المساهمة فقط.

ان تعبئتكم لنموذج الاستبيان المرفق مع هذا الخطاب لهي مشاركة جادة منكم في دعم العملية التعليمية والبحث العلمي في المملكة العربية السعودية ومبادرة منكم لتطوير نظام ال corporate governance في شركاتنا المساهمة للنهوض بمستوى الأداء العام لهذه الشركات وبمستوى الرقابة بشكل أدق. ان هذا الاستبيان لهو الوسيلة الأفضل لكي يستطيع الباحث من تحليل وتقييم النظام الرقابي في الشركات المساهمة ومحاولة تحديد نقاط الضعف والقوة ومن ثم البحث عن أفضل السبل المتبعة عالميا لمعالجة القصور، ان وجد، أو تطوير النظام بما يتفق مع السياسات المتبعة دوليا من قبل الشركات المنظمة لل corporate governance ولعل من أهمها منظمة التعاون والتنمية الأقتصادية (OECD).

مع أن مشاركتكم مهمة جدا لاكمال هذا البحث، الا أن المشاركة اختيارية. تم مراعاة أهمية وقتكم عند اعداد الأسئلة فاجاباتها جميعا تكون عن طريق وضع علامة (√) في الخانة التي تراها مناسبة.

وادراكا لأهمية سرية المعلومات فان كتابة الاسم على الاستبيان غير مطلوبة. الباحث يهدف الى تقييم الشركات المساهمة في المملكة ككل وليس الى تقييم شركة بعينها. أيضا فانه يجدر التنبيه هنا بأن جميع نتائج الاستبيان ستعامل بدرجة عالية من السرية. المعلومات ستكون متاحة فقط للباحث ومرشده الأكاديمي ومناقشين الرسالة وجامعة فكتوريا في استراليا فقط.

أشكر الجميع على المشاركة في هذا الاستبيان وأرجو أن يتم اعادة الاستبيان في خلال ثلاث أسابيع من استلامه اما عن طريق البريد (سيتم ارفاق بريد مدفوع القيمة ومكتوب علية عنوان الباحث) أو عن طريق الفاكس.

أشكر لكم حسن تعاملكم واهتمامكم، وجزاكم الله عنا وعن المسلمين خير الجزاء

أخوكم الباحث: خالد بن حمد التركي

Should you have any queries regarding the project or questionnaire, please feel free to contact me on (0555132301) or e-mail me at: saudiphd@hotmail.com or my senior supervisor, Professor Robert Clift, on e-mail: bob.clift@vu.edu.au, or you may contact the Chairman, University Human Research Ethics Committee, Faculty of Business and Law, Victoria University of Technology, P.O. Box 14428 MCMC, Melbourne, 8001 (e-mail: nick.billington@vu.edu.au).

King Saud University جامعة الملك سعود

عزيزي المشارك،،

السلام عليكم ورحمة الله وبركاتة   وبعد

خالد بن حمد التركي هو أحد المحاظرين في قسم المحاسبة، كلية الاقتصاد والادارة، جامعة الملك سعود – فرع القصيم – وهو في الوقت الراهن يحظر لدرجة الدكتوراه في تخصص المحاسبة في جامعة فكتوريا في استراليا. موضوع الرسالة يتعلق بحوكمة الشركات المساهمة في المملكة العربية السعودية.

ان تعبئتكم لنموذج الاستبيان المرفق مع هذا الخطاب لهي دعم من سعادتكم لانجاح هذا المشروع العلمي حيث أن استكمال الرسالة يعتمد بشكل أساسي على نتائج هذا الاستبيان.

تم كتابة هذا الخطاب بناء على طلب الزميل خالد التركي وذلك للتأكيد على أنه سيتم التعامل مع المعلومات المطلوبة بشكل سري وكذلك للتأكيد على أن النتائج ستكون متوفره فقط للطالب والمشرفين على رسالته ولمن سوف يقوم بمناقشة الرسالة ولجامعة فكتوريا في استراليا.

وختاما أتقدم لسعادتكم بالشكر الجزيل على حسن تعونكم ووفقكم الله

وفي حال وجود أي استفسار أرجو عدم التردد بالارسال لي على بيانات الاتصال بالأسفل

دكتور/ عبيد بن سعد المطيري
رئيس قسم المحاسبة
بريد الكتروني:
o.almotairy@hotmail.com

القسم الأول: الأسئلة العامة:

الأسئلة التالية هي أسئلة عـــــامة. أرجو وضع علامة (√) أمام ماتراه مناسبا(ملاحظة: يمكن التأشير على أكثر من خيار):

١- في أي مجموعة من المجموعات التالية تستطيع أن تصنف نفسك؟

	عضو مجلس ادارة		مد يــــر الشركة
	عضو في لجنـــة المراجعة		مســــــاهم

٢- ماهو نشاط الشركة التي تعمل فيها أو تمتلك معظم أسهمك فيها اذا كنت مساهم؟

	البنوك		الخدمات		الاتصالات
	الاسمنت		الصناعة		
	الزراعة		الكهرباء		

٣- ماهي فئتك العمرية؟

	أقل من ٢٥ سنة		من ٢٦ الى ٣٥		من ٣٦ الى ٤٥
	من ٤٦ الى ٥٥		من ٥٦ الى ٦٥		أكثر من ٦٦

٤- ماهو أعلى مؤهل علمي حصلت عليه؟

	أقل من ثانوية عامة		ثانوية عامة
	بكاليريوس		ماجستير
	دكتوراه		غيره ....

٥- من أين حصلت على أعلى مؤهلاتك؟

	المملكة العربية السعودية		أميركا		بريطانيا
	استراليا		مكان اخر		

٦- ماذا كان التخصص؟ ....

٧- كم عدد سنوات خبرتك في المجال الذي تعمل فيه؟

	٥ سنوات أو أقل		من ٦ الى ١٠ سنوات		من ١١ الى ١٥ سنة
	من ١٦ الى ٢٠ سنة		من ٢١ الى ٢٥ سنة		أكثر من ٢٥ سنة

٨- اذا كنت مساهما، كم اجمالي عدد الأسهم التي تمتلكها في جميع الشركات؟

	أقل من ٥٠٠		500 - 999		١٠٠٠ - ١٩٩٩
	٢٠٠٠ - ٤٩٩٩		٥٠٠٠ - ٩٩٩٩		أكثر من ١٠٠٠٠ سنة

القسم الثاني: أسئلة عن الكوربيرت قوفرننس

٢-١. حقوق المساهمين:

في هذا القسم سيتم عرض عدد من الحقوق التي يفترض أن يتمتع بها المساهمين في الشركات. سيتم عرض هذه الحقوق على شكل جمل والمطلوب منك هو ابداء رأيك الشخصي عن مدى قوة كل جملة أو عبارة في المؤسسة التي تنتمي اليها أو تمتلك غالبية أسهمك فيها اذا كنت مساهم. فقط ضع علامة (√) أمام ماتراه مناسبا بناء على تقييمك للواقع الفعلي وليس المفترض.

الجملة	لاأوافق مطلقا	لاأوافق	محايد	أوافق	أوافق بقوة
يستطيع المساهم شراء الأسهم بطريقة امنة					
يمتلك المساهم حق التصرف في الأسهم التي يمتلكها					
يحصل المساهم على المعلومات التي يريدها بتوقيت مناسب وبشكل دوري					
يعي المساهم الحقوق المفترضة له					
يهتم المساهم بحظور الجمعية العمومية					
يحصل المساهم على المعلومات المتعلقة بالجمعية العمومية في الوقت المناسب (وقت الانعقاد – المكان – جدول الأعمال)					
يستطيع المساهم المشاركة في النقاش في الجمعية العمومية وتوجيه أسئلة لأعضاء مجلس الادارة					
يمتلك المساهم الحق في التصويت ويستطيع أن يقترح مواضيع ليتم مناقشتها في الجمعية					
يحصل المساهم على أربـــــاح سنوية في حال ربح الشركة					
المساهم هو الذي يرشح أعضـــاء مجلس الادارة					
كل المساهمين داخل فئة معينة يعاملون معاملة متساوية					
كل المساهمين داخل كل فئة لهم نفس حقوق التصويت (١ سهم = ١ صوت)					
الاجراءات والخطوات المتبعة لتنظيم الجمعية العمومية تتم على اعتبار المساواة في المعاملة مع جميع المساهمين					
تسريب المعلومات داخل الشركة بغرض أن يستفيد منها المدراء وكبار الموظفين قبل نشرها للعموم امر ممنوع قطعيا في المؤسسة					
بشكل عام أستطيع القول بأن المساهم يحصل على حقوقه المفترضة بشكل ايجابي					

٢-٢. مجلس الإدارة:

في هذا القسم سيتم عرض عدد من التنظيمات والواجبات المطلوبة من مجلس ادارة الشركات المساهمة ممثلا بأعضائه التنفيذيين وغير التنفيذيين لضمان فعالية المجلس. سيتم عرض هذه الواجبات على شكل جمل والمطلوب منك هو ابداء رأيك الشخصي عن مدى قوة كل نقطة أو جملة في الجدول التالي في المؤسسة التي تنتمي اليها أو تمتلك غالبية أسهمك فيها اذا كنت مساهم. فقط ضع علامة (√) أمام ماتراه مناسبا بناء على تقييمك للواقع الفعلي وليس المفترض.

الجملة	لاأوافق مطلقا	لاأوافق	محـــايد	أوافق	أوافق بقوة
يتولى مجلس الادارة عملية الرقابة على الادارة التنفيذية في الشركة					
لدى أعضاء مجلس الادارة المعرفة الكافية والاخلاص في العمل مع بذل الجهد اللازم والاهتمام بالعمل لصالح مؤسستهم					
أعضاء مجلس الادارة يتوخون العدل والمساواة في معاملة جميع المساهمين					
يوجد على الأقل ثلاث أعضاء غير تنفيذيين في مجلس الادارة					
يهتم المجلس بمدى الامتثال للقوانين الصادرة ويأخذ في الاعتبار مصالح أصحاب الحقوق من دائنين وغيرهم					
يقوم أعضاء المجلس بواجباتهم الرئيسية على أكمل وجه ومن هذه الواجبات: مراجعة وتنقيح استراتيجية الشركة وخططها الأساسية وميزانياتها					
رسم الأهداف المستقبلية للشركة					
الرقابة على أداء الشركة واجراءات الافصاح					
التأكد من سلامة نظام المحاسبة والتقارير المالية					
لا يقدم اعضاء مجلس الإدارة اي استشارات لشركتهم ولا ينتسبون لاي شركة تقدم استشارات للشركة او للإدارة					
لاينتسب اعضاء مجلس الإدارة لاي من كبار عملاء الشركة او مقدمي الخدمات					
يتفرع من المجلس لجنة مستقلة للمكافآت والتعويضات					
يتفرع من المجلس لجنة مستقلة للترشيح والترقيات					
يتفرع من المجلس لجنة مستقلة للمراجعة (لجنة مراجعة)					
سياسة الشركة تفصل بين وظيفتي إدارة الشركة ورئاسة مجلس الإدارة					
يكرس عضو مجلس الإدارة الوقت الكافي للقيام بمسؤلياته ويحضر على الأقل ٧٥% من الإجتماعات في المتوسط					
يعقد مجلس إدارة الشركة اربع اجتماعات على الأقل في السنة					
يستطيع عضو مجلس الإدارة الحصول على المعلومات التي يريدها بدقة وتوقيت مناسبين					
بشكل عام أستطيع القول بأن مجلس إدارة الشركة فعّال					

٣-٢ لجنة المراجعة والمراجعة الداخلية بالشركة:

في هذا القسم سيتم عرض عدد من التنظيمات والواجبات المطلوبة من لجنة المراجعة في الشركات المساهمة ممثلة بأعضائها لضمان فعالية هذه اللجنة. سيتم عرض هذه الواجبات على شكل جمل والمطلوب منك هو ابداء رأيك الشخصي عن مدى قوة كل نقطة أو جملة في الجدول التالي في المؤسسة التي تنتمي اليها أو تمتلك غالبية أسهمك فيها اذا كنت مساهم. فقط ضع علامة (√) أمام ماتراه مناسبا بناء على تقييمك للواقع الفعلي وليس المفترض.

الجملة	لاأوافق مطلقا	لاأوافق	محايد	أوافق	أوافق بقوة
يوجد في الشركة لجنة مراجعة مستقلة					
تتولى لجنة المراجعة عملية الرقابة على مدى فعالية نظام المراجعة الداخلية في الشركة					
تتولى اللجنة عملية تعيين وفصل رئيس قسم المراجعة الداخلية في الشركة وتناقش معه مواضيع مثل: تقرير المراجهة الداخلية، فعالية نظام الرقابة الداخلية في الشركة، المشاكل التي يواجهها المراجعون الداخليون					
تقدم اللجنة توصيات لمجلس إدارة الشركة بخصوص ترشيح وتعيين المراجع الخارجي ومكآفئاته وتحديد مدة مراجعة للشركة بعد أن يقوم المساهمون بترشيح المراجع الخارجي في إجتماع الجمعية العمومية					
تقوم اللجنة بمراجعة ومراقبة سلامة التقارير المالية في الشركة قبل ان يتم اعتمادها من قبل مجلس الإدارة ونشرها للمساهمين وذلك لضمان موضوعيتها ودقتها وتوقيتها المناسب					
يوجد أربع ة أعضاء غير تنفيذيين في لجنة المراجعة					
يوجد من ضمن أعضاء اللجنة من لديه التأهيل والخبرة الكافيتين في مجال المحاسبة والمراجعة					
يدرك عضو لجنة المراحعة الأعمال الأساسية الواجبة عليه					
تجتمع لجنة المراجعة على الأقل أربع مرات في السنة					
يحضر عضو لجنة المراجعة على الأقل ٧٥% من اجتماعات اللجنة					
يتم تزويد أعضاء اللجنة بجدول أعمال الاجتماع قبل الاجتماع بفتره كافية					
يتم تزويد اجتماع الجمعية العمومية للشركة بتقرير عن نشاطات لجنة المراجعة					
تستطيع اللجنة الوصول الى المعلومات التي تحتاجها من الشركة متى أرادت ذلك					
أهداف ومسؤليات ومدى نفوذ لجنة المراجعة محددة بشكل واضح في بيان مكتوب او مايسمى بالدستور					
بشكل عام أستطيع القول بأن لجنة المراجعة فعّالة					

٢-٤. الإ فصـــــــاح والشفافية:

في هذا القسم سيتم عرض عدد من الإجراءات المطلوبة من الشركات المساهمة في المملكة العربية السعودية لضمان فعالية نظام الإفصـــاح والشفافية في المؤسسة. سيتم عرض هذه الإجراءات على شكل جمل والمطلوب منك هو ابداء رأيك الشخصي عن مدى قوة كل نقطة أو جملة في الجدول التالي في المؤسسة التي تنتمي اليها أو تمتلك غالبية أسهمك فيها اذا كنت مساهم. فقط ضع علامة (√) أمام ماتراه مناسبا بناء على تقييمك للواقع الفعلي وليس المفترض.

الجملة	لاأوافق مطلقاً	لاأوافق	محـــايد	أوافق	أوافق بقوة
يلقى الافصاح والشفافية اهتماما كبيرا من قبل الشركة					
تفصح الشركة عن أهدافها الأساسية وسياساتها					
تقوم الشركة بنشر قوائمها المالية في الصحف الرسمية					
تمتلك الشركة موقع على الإنترنت غني بالمعلومات الأساسية عن الشركة					
يتم تقديم المعلومات الأساسية والهامة للمستثمر باللغة العربية					
يتم تقديم المعلومات الأساسية والهامة للمستثمر باللغة الانجليزية					
تفصح الشركة عن تقسيم رأس مالها وعن حقوق التصويت					
تفصح الشركة عن أسماء أعضاء مجلس إدارتها وعدد الأعضاء الغير تنفيذيين					
يتم الإفصاح عن مكافآت أعضاء مجلس الإدارة					
يتم الإفصاح عن الأزمات المالية والأخطار المتوقعة للشركة وأثر ذلك على الأرباح					
يتم الإفصاح عن المسائل المالية المتعلقة بالموظفين واصحاب الحقوق					
يتم الإفصاح عن التنظيم الإداري والقانوني في الشركة					
يتم تجهيز معلومات الشركة المالية وغير المالية ومراجعتها ونشرها بناء على نظام المحاسبة والمراجعة المتبع في المملكة					
قنوات الإفصاح ونشر المعلومات في المؤسسة تقوم على أساس من العدل والتوقيت المناسب لتوصيلها بشفافية الى المستفيدين					
بشكل عام أستطيع القول بأن الإفصاح والشفافية فعّالتان في الشركة					

انتهت الأسئلة بحمد الله ،،

أشكركم جزيل الشكر على تكرمكم بملأ هذا الاستبيان الذي أسأل الله تعالى أن يعينني على حسن ادارته واستغلاله وأن تتمحض خلاصة عمل أربع سنوات بكل مافيه فائدة لهذا البلد الغالي وخاصة الشركات المساهمة في المملكة العربية السعودية والمساهمين على وجه العموم وأن تكون ثمرة هذا العمل هي تعزيز فاعلية نظام الرقابية في مملكتنا وتطويره بما يتوافق مع أفضل وأحدث ماتوصلت اليه الدول المتقدمه.

أرجو اعادة هذا الاستبيان بعد استكماله الى عنوان بريدي الموضح في الاسفل كما يمكن ارساله على الفاكس اذا كان ذلك اسهل، ولا يشترط وضع أسماء على الاستبيان أو على البريد وذلك حفاظا على خصوصيتكم

خالد بن حمد التركي
ص.ب. ١٦٦٦ البكيرية
القصيم، الرمز البريدي ٥١٩٤١
المملكة العربية السعودية
جوال: ٠٥٥٥١٣٢٣٠١
فاكس:
063800565

أشكركم مرة أخرى على تعاونكم ،،
وجزاكم الله خير الجزاء،،

أخوكم ،،

خالد بن حمد التركي

مبتعث من قبل جامعة الملك سعود لاستكمال درجة الدكتوراه في مجال المحاسبة في جامعة فكتوريا في استراليا

APPENDIX III

Ethics Approval Letter from Victoria University

4.5 BHREC 2003/35 – *Corporate Governance in Saudi Arabia* (Professor RobertClift/Mr. Michael DeMartinis/Khalid Al-Turki) (Re-submitted).

The Committee asked that the researchers make the following amendments:

· The Consent Form should contain some information advising participants that they can refer to the Human Research Ethics Committee if they have any concerns with the research. Contact details for the committee should also be included.

· Further clarification is still required about the funding of the project. Is the project, the student or a Faculty member being funded?

Resolved to authorise the Chair to approve the proposal when these matters had been resolved to his satisfaction.

VICTORIA UNIVERSITY

A NEW SCHOOL OF THOUGHT

Professor Robert Clift
School of Accounting and Finance
Footscray Park Campus

Dear Professor Clift,

I am writing to confirm that the ethics application

BHREC 2003/35 – Corporate Governance in Saudi Arabia

received out of session approval from the Chair of the Human Research Ethics Committee, Faculty of Business and Law in July 2004.

Yours sincerely,

[redacted]

Tina Jeggo
Secretary, Human Research Ethics Committee
Faculty of Business and Law

On behalf of
Dr Nick Billington
Chair, Human Research Ethics Committee
Faculty of Business and Law

Cc: Mr Khalid Al-Turki

APPENDIX IV

STATISTICAL TABLES

Table A Critical Values of 'T'
(Two Tailed Significance)

	0.2	0.1	0.05	0.01	0.005	0.001	0.0005	0.0001
2	1.89	2.92	4.30	9.92	14.09	31.60	44.70	100.14
3	1.64	2.35	3.18	5.84	7.45	12.92	16.33	28.01
4	1.53	2.13	2.78	4.60	5.60	8.61	10.31	15.53
5	1.48	2.02	2.57	4.03	4.77	6.87	7.98	11.18
6	1.44	1.94	2.45	3.71	4.32	5.96	6.79	9.08
7	1.41	1.89	2.36	3.50	4.03	5.41	6.08	7.89
8	1.40	1.86	2.31	3.36	3.83	5.04	5.62	7.12
9	1.38	1.83	2.26	3.25	3.69	4.78	5.29	6.59
10	1.37	1.81	2.23	3.17	3.58	4.59	5.05	6.21
11	1.36	1.80	2.20	3.11	3.50	4.44	4.86	5.92
12	1.36	1.78	2.18	3.05	3.43	4.32	4.72	5.70
13	1.35	1.77	2.16	3.01	3.37	4.22	4.60	5.51
14	1.35	1.76	2.14	2.98	3.33	4.14	4.50	5.36
15	1.34	1.75	2.13	2.95	3.29	4.07	4.42	5.24
16	1.34	1.75	2.12	2.92	3.25	4.01	4.35	5.13
17	1.33	1.74	2.11	2.90	3.22	3.97	4.29	5.04
18	1.33	1.73	2.10	2.88	3.20	3.92	4.23	4.97
19	1.33	1.73	2.09	2.86	3.17	3.88	4.19	4.90
20	1.33	1.72	2.09	2.85	3.15	3.85	4.15	4.84
21	1.32	1.72	2.08	2.83	3.14	3.82	4.11	4.78
22	1.32	1.72	2.07	2.82	3.12	3.79	4.08	4.74
23	1.32	1.71	2.07	2.81	3.10	3.77	4.05	4.69
24	1.32	1.71	2.06	2.80	3.09	3.75	4.02	4.65
25	1.32	1.71	2.06	2.79	3.08	3.73	4.00	4.62
26	1.31	1.71	2.06	2.78	3.07	3.71	3.97	4.59
27	1.31	1.70	2.05	2.77	3.06	3.69	3.95	4.56
28	1.31	1.70	2.05	2.76	3.05	3.67	3.93	4.53
29	1.31	1.70	2.05	2.76	3.04	3.66	3.92	4.51
30	1.31	1.70	2.04	2.75	3.03	3.65	3.90	4.48
35	1.31	1.69	2.03	2.72	3.00	3.59	3.84	4.39
40	1.30	1.68	2.02	2.70	2.97	3.55	3.79	4.32
45	1.30	1.68	2.01	2.69	2.95	3.52	3.75	4.27
	0.2	0.1	0.05	0.01	0.005	0.001	0.0005	0.0001

50	1.30	1.68	2.01	2.68	2.94	3.50	3.72	4.23
55	1.30	1.67	2.00	2.67	2.92	3.48	3.70	4.20
60	1.30	1.67	2.00	2.66	2.91	3.46	3.68	4.17
65	1.29	1.67	2.00	2.65	2.91	3.45	3.66	4.15
70	1.29	1.67	1.99	2.65	2.90	3.43	3.65	4.13
75	1.29	1.67	1.99	2.64	2.89	3.42	3.64	4.11
80	1.29	1.66	1.99	2.64	2.89	3.42	3.63	4.10
85	1.29	1.66	1.99	2.63	2.88	3.41	3.62	4.08
90	1.29	1.66	1.99	2.63	2.88	3.40	3.61	4.07
95	1.29	1.66	1.99	2.63	2.87	3.40	3.60	4.06
100	1.29	1.66	1.98	2.63	2.87	3.39	3.60	4.05
200	1.29	1.65	1.97	2.60	2.84	3.34	3.54	3.97
500	1.28	1.65	1.96	2.59	2.82	3.31	3.50	3.92
1000	1.28	1.65	1.96	2.58	2.81	3.30	3.49	3.91
Infinity	1.28	1.64	1.96	2.58	2.81	3.29	3.48	3.89
	Source		**Berenson, Levine and Timothy (2005)**					

Table B Critical Values of 'F'
($\alpha = 0.05$)

df2/df1	1	2	3	4	5	6	7	8	9	10	12	15	20	24	30	40	60	120	INF
1	161.45	199.50	215.71	224.58	230.16	233.99	236.77	238.88	240.54	241.88	243.91	245.95	248.01	249.05	250.10	251.14	252.20	253.25	254.31
2	18.51	19.00	19.16	19.25	19.30	19.33	19.35	19.37	19.38	19.40	19.41	19.43	19.45	19.45	19.46	19.47	19.48	19.49	19.50
3	10.13	9.55	9.28	9.12	9.01	8.94	8.89	8.85	8.81	8.79	8.74	8.70	8.66	8.64	8.62	8.59	8.57	8.55	8.53
4	7.71	6.94	6.59	6.39	6.26	6.16	6.09	6.04	6.00	5.96	5.91	5.86	5.80	5.77	5.75	5.72	5.69	5.66	5.63
5	6.61	5.79	5.41	5.19	5.05	4.95	4.88	4.82	4.77	4.74	4.68	4.62	4.56	4.53	4.50	4.46	4.43	4.40	4.37
6	5.99	5.14	4.76	4.53	4.39	4.28	4.21	4.15	4.10	4.06	4.00	3.94	3.87	3.84	3.81	3.77	3.74	3.70	3.67
7	5.59	4.74	4.35	4.12	3.97	3.87	3.79	3.73	3.68	3.64	3.57	3.51	3.44	3.41	3.38	3.34	3.30	3.27	3.23
8	5.32	4.46	4.07	3.84	3.69	3.58	3.50	3.44	3.39	3.35	3.28	3.22	3.15	3.12	3.08	3.04	3.01	2.97	2.93
9	5.12	4.26	3.86	3.63	3.48	3.37	3.29	3.23	3.18	3.14	3.07	3.01	2.94	2.90	2.86	2.83	2.79	2.75	2.71
10	4.96	4.10	3.71	3.48	3.33	3.22	3.14	3.07	3.02	2.98	2.91	2.85	2.77	2.74	2.70	2.66	2.62	2.58	2.54
11	4.84	3.98	3.59	3.36	3.20	3.09	3.01	2.95	2.90	2.85	2.79	2.72	2.65	2.61	2.57	2.53	2.49	2.45	2.40
12	4.75	3.89	3.49	3.26	3.11	3.00	2.91	2.85	2.80	2.75	2.69	2.62	2.54	2.51	2.47	2.43	2.38	2.34	2.30
13	4.67	3.81	3.41	3.18	3.03	2.92	2.83	2.77	2.71	2.67	2.60	2.53	2.46	2.42	2.38	2.34	2.30	2.25	2.21
14	4.60	3.74	3.34	3.11	2.96	2.85	2.76	2.70	2.65	2.60	2.53	2.46	2.39	2.35	2.31	2.27	2.22	2.18	2.13
15	4.54	3.68	3.29	3.06	2.90	2.79	2.71	2.64	2.59	2.54	2.48	2.40	2.33	2.29	2.25	2.20	2.16	2.11	2.07
16	4.49	3.63	3.24	3.01	2.85	2.74	2.66	2.59	2.54	2.49	2.42	2.35	2.28	2.24	2.19	2.15	2.11	2.06	2.01
17	4.45	3.59	3.20	2.96	2.81	2.70	2.61	2.55	2.49	2.45	2.38	2.31	2.23	2.19	2.15	2.10	2.06	2.01	1.96
18	4.41	3.55	3.16	2.93	2.77	2.66	2.58	2.51	2.46	2.41	2.34	2.27	2.19	2.15	2.11	2.06	2.02	1.97	1.92
19	4.38	3.52	3.13	2.90	2.74	2.63	2.54	2.48	2.42	2.38	2.31	2.23	2.16	2.11	2.07	2.03	1.98	1.93	1.88
20	4.35	3.49	3.10	2.87	2.71	2.60	2.51	2.45	2.39	2.35	2.28	2.20	2.12	2.08	2.04	1.99	1.95	1.90	1.84
21	4.32	3.47	3.07	2.84	2.68	2.57	2.49	2.42	2.37	2.32	2.25	2.18	2.10	2.05	2.01	1.96	1.92	1.87	1.81
22	4.30	3.44	3.05	2.82	2.66	2.55	2.46	2.40	2.34	2.30	2.23	2.15	2.07	2.03	1.98	1.94	1.89	1.84	1.78
23	4.28	3.42	3.03	2.80	2.64	2.53	2.44	2.37	2.32	2.27	2.20	2.13	2.05	2.01	1.96	1.91	1.86	1.81	1.76
24	4.26	3.40	3.01	2.78	2.62	2.51	2.42	2.36	2.30	2.25	2.18	2.11	2.03	1.98	1.94	1.89	1.84	1.79	1.73
25	4.24	3.39	2.99	2.76	2.60	2.49	2.40	2.34	2.28	2.24	2.16	2.09	2.01	1.96	1.92	1.87	1.82	1.77	1.71
26	4.23	3.37	2.98	2.74	2.59	2.47	2.39	2.32	2.27	2.22	2.15	2.07	1.99	1.95	1.90	1.85	1.80	1.75	1.69
27	4.21	3.35	2.96	2.73	2.57	2.46	2.37	2.31	2.25	2.20	2.13	2.06	1.97	1.93	1.88	1.84	1.79	1.73	1.67
28	4.20	3.34	2.95	2.71	2.56	2.45	2.36	2.29	2.24	2.19	2.12	2.04	1.96	1.91	1.87	1.82	1.77	1.71	1.65
29	4.18	3.33	2.93	2.70	2.55	2.43	2.35	2.28	2.22	2.18	2.10	2.03	1.94	1.90	1.85	1.81	1.75	1.70	1.64
30	4.17	3.32	2.92	2.69	2.53	2.42	2.33	2.27	2.21	2.16	2.09	2.01	1.93	1.89	1.84	1.79	1.74	1.68	1.62
40	4.08	3.23	2.84	2.61	2.45	2.34	2.25	2.18	2.12	2.08	2.00	1.92	1.84	1.79	1.74	1.69	1.64	1.58	1.51
60	4.00	3.15	2.76	2.53	2.37	2.25	2.17	2.10	2.04	1.99	1.92	1.84	1.75	1.70	1.65	1.59	1.53	1.47	1.39
120	3.92	3.07	2.68	2.45	2.29	2.18	2.09	2.02	1.96	1.91	1.83	1.75	1.66	1.61	1.55	1.50	1.43	1.35	1.25
inf	3.84	3.00	2.60	2.37	2.21	2.10	2.01	1.94	1.88	1.83	1.75	1.67	1.57	1.52	1.46	1.39	1.32	1.22	1.00

Source **Berenson, Levine and Timothy (2005)**

APPENDIX V

CODES OF CORPORATE GOVERNANCE BEST PRACTICES WORLD WIDE

Appendix "5": Partial Listing of Corporate Governance Guidelines and Codes of "Best Practice"

No.	Country	Code Title	Date	Provenance	Link
1	The United States Of America	Statement on Corporate Governance	1997	The Business Roundtable	http://www.brtable.org/pdf/11.pdf
		CalPERS	1998	CalPERS	http://www.calpers-governance.org/principles/domestic/us/downloads/us-corpgov-principles.pdf
		Report of the Blue Ribbon Committee on Improving the Effectiveness of Corporate Audit Committees	February 1999	National Association of Corporate Directors	http://www.nasd.com/docs/textapp.pdf
		TIAA-CREF Policy Statement on Corporate Governance	2000	Teachers Insurance and Annuity Association-College Retirement Equities Fund	http://www.tiaa-cref.org/libra/governance
		NACD Blue Ribbon	1996 reissued 2001	National Association of Corporate Directors	http://www.ecgi.de/codes/country_documents/usa/nacd_cbl.pdf
		Principles of Corporate Governance: Analysis & Recommendations	1994, revised 2002	American Law Institute	http://www.ali.org/index.htm
		Core Policies, General Principles, Positions & Explanatory Notes	1998 revised 2002	Council of Institutional Investors	http://www.cii.org/corp_governance.asp
		Principles of Corporate Governance	2002	The Business Roundtable	http://www.brtable.org/pdf/704.pdf
		Corporate Governance Rule Proposals	2002	NYSE	www.nyse.com/pdfs/amend1-04-09-03.pdf
		Commission on Public Trust and Private Enterprise Findings and Recommendations	2003	The Conference Board	http://www.ecgi.de/codes/country_documents/usa/757.pdf

2	OECD	OECD Principles of Corporate Governance	May 1999 amended 2004	Organisation for Economic Co-operation and Development www.oecd.org	http://www.oecd.org/dataoecd/47/50/4347646.pdf
3	United Kingdom	Cadbury Report	1 Dec. 1992	London Stock Exchange	http://www.worldbank.org/html/fpd/privatesector/cg/docs/cadbury.pdf
		Greenbury Report	17 July 1995	CPI	http://www.ecgi.de/codes/country_documents/uk/greenbury.pdf
		Hampel Report	January 1998	London Stock Exchange	http://www.ecgn.ulb.ac.be/ecgn/docs/codes/Hampel2/hampel2.htm
		Turnbull Report	Sept. 1999	Institute of Chartered Accountants	http://www.icaew.co.uk/viewer/index.cfm?AUB=TB2I_6342&tb5=1
		The KPMG Review Internal Control: A Practical Guide	October 1999	KPMG Audit Committee Institute (ACI)	http://www.ecgi.de/codes/country_documents/uk/kpmg_internal_control_practical_guide.pdf
		Hermes Statement on International Voting Principles	13 Dec. 1999	Hermes Pensions Management	http://www.ecgi.de/codes/country_documents/uk/hermes_igp_en.pdf
		The Combined Code: Principles of Good Governance and Code of Best Practice	May 2000	The Committee on Corporate Governance	http://www.ecgi.de/codes/country_documents/uk/combined_code.pdf
		Code of Good Practice	January 2001	Association of Unit Trusts and Investment Fund (AUTIF)	http://www.investmentfunds.org.uk/investmentuk/about_ima/good_practice/goodpractice.pdf
		Review of the role and effectiveness of non-executive directors	7 June 2002	Department of Trade and Industry	http://www.dti.gov.uk/cld/non_exec_review/pdfs/morifulldata.pdf
		The Hermes Principles	21 October 2002	Hermes Pension Management Limited	http://www.ecgi.de/codes/country_documents/uk/hermes_principles.pdf
		The Responsibilities of Institutional Shareholders and Agents - Statement of Principles	21 October 2002	Institutional Shareholders' Committee	http://www.ecgi.de/codes/country_documents/uk/isc_statement_of_principles.pdf
		Review of the role and effectiveness of non-executive directors	January 2003	The Department of Trade and Industry	http://www.ecgi.de/codes/country_documents/uk/higgsreport.pdf
		The Smith Report	January 2003	Financial Reporting Council	http://www.ecgi.de/codes/country_documents/uk/ac_report.pdf

		The Combined Code on Corporate Governance	23 July 2003	The Financial Reporting Council (FRC)	http://www.frc.org.uk/publications/content/CombinedCodeFinal.pdf
4	Australia	Bosch Report	1995	Working Group	Enquiries can be directed to: robertco@woodslane.com.au
		AIMA Guide & Statement of Recommended Practice	June 1995	Investment & Financial Services Association	Australian Investment Managers' Association (1995). "A Guide for Investment Managers & A Statement of Recommended Corporate Practice". 30 pages.
		Corporate Governance - Volume One: in Principle	N/A	The Audit Office of New South Wales, Australia	http://www.audit.nsw.gov.au/crpg1-97/crpg1-97.pdf
		Corporate Governance - Volume Two: In Practice	N/A	The Audit Office of New South Wales, Australia	http://www.audit.nsw.gov.au/crpg2-97/crpg2-97.pdf
		Corporate Governance: A Guide for Investment Managers and Corporations	July 1999	Investment & Financial Services Association	http://www.ecgi.de/codes/country_documents/australia/ifsa_july1999.pdf
		Horwath 2002 Corporate Governance Report	2002	University of Newcastle Business School	http://www.newcastle.edu.au/school/newc-business/welcome/howarth.pdf
		Corporate Governance: A guide for fund managers and corporations	Dec. 2002	Investment & Financial Services Association	http://www.ecgi.de/codes/country_documents/australia/ifsa_december_2002.pdf
5	Austria	Österreichischer Corporate Governance Kodex (Austrian Code of Corporate Governance)	Septmber 2002	Österreichischer Arbeitskreis für Corporate Governance	http://www.ecgi.de/codes/country_documents/austria/osterr_cg_kodex_200902.pdf
6	Belgium	Corporate Governance (Recommendations)	January 1998	Federation of Belgain Enterprises	http://www.ecgi.de/codes/country_documents/belgium/vbo_feb_en.pdf
		Banking and Finance Commission Report	1998	Commission Bancaire et Financière	N/A
		Cardon Report	1998	Belgian Corporate Governance Commission	N/A

		Merged Code	December 1998	Belgian Corporate Governance Commission	http://www.ecgi.de/codes/country_documents/belgium/be_mergedcode.pdf
		Guidelines on Corporate Governance Reporting	18 November 1999	N/A	N/A
		Director's Charter	January 2000	Directors Foundation	http://www.ecgi.de/codes/country_documents/belgium/fda_code_eng.pdf
7	Brazil	Code of Best Practice of Corporate Governance	8 May 1999 revised 9 April 2001	Instituto Brasileiro de Governanca Corporativa (IBGC)	http://www.ecgi.de/codes/country_documents/brazil/kf_mck_governan.pdf
		Recomendações sobre Governança Corporativa	June 2002	Comissao de Valores Mobiliarios (CVM)	http://www.ecgi.de/codes/country_documents/brazil/code_june2002_en.pdf
8	Canada	The Toronto Report	1994	N/A	http://www.ecgi.de/codes/country_documents/canada/dey.pdf
		Five Years to the Dey	June 1999	Toronto Stock Exchange	http://142.201.0.1/en/pdf/5years.pdf
		Beyond Compliance: Building a Governance Culture (Saucier Report)	November 2001	Joint Committee on Corporate Governance (JCCG)	http://www.ecgi.de/codes/country_documents/canada/beyond_compliance.pdf
		Corporate Governance Policy– Proposed New Disclosure Requirement and Amended Guidelines	26 March 2002	Toronto Stock Exchange www.tse.com	http://142.201.0.1/en/pdf/notices/April26-2002-RequestforComments-113.pdf
9	Cyprus	Corporate Governance Code	17 March 2003	The Cyprus Stock Exchange	http://www.cse.com.cy/MarketData/Data/Corporate%20Governance%20official%20translation%
10	Czech Republic	Revised Corporate Governance Code (Based on the OECD Principles)	February 2001	Czech Securities Commission	http://www.sec.cz/download/Next/CG_CODE.doc
11	Denmark	Guidelines on Good Management of a Listed Company (Corporate Governance)	February 2000	Danish Shareholders Association	http://www.ecgi.de/codes/country_documents/denmark/corporate_daf_e.pdf
		The Nørby Committee's report on Corporate Governance in Denmark	6 December 2001	Copenhagen Stock Exchange	http://www.ecgi.de/codes/country_documents/denmark/haa_kap05-01uk.pdf

12	France	Vienot I Report	July 1995	Conseil National du Patronat Francais and Association Francaise des Entreprises Privees	http://www.ecgi.de/codes/country_documents/france/vienot1_en.pdf
		Vienot II Report	July 1999	Mouvement des Entreprises de France and Association Francaise des Enterprises Privees	http://www.ecgi.de/codes/country_documents/france/vienot2_en.pdf
		Recommendations on Corporate Governance	June 1998 amended 2001	AFG-ASFFI Commission on Corporate Governance	http://www.ecgi.de/codes/country_documents/france/afg_asfff_amended_2001.pdf
		Pour un meilleur gouvernement des entreprises cotées	23 September 2002	MEDEF and AFEP-AGREF	http://www.ecgi.de/codes/country_documents/france/rapport_bouton_en.pdf
13	Germany	Drittes Finanzmarkt förderungsgesetz	1 April 1998	N/A	http://www.ecgi.de/codes/country_documents/germany/gkontrag.pdf
		Gesetz zur Kontrolle und Transparenz im Unternehmensbereich (KonTraG)	5 March 1998	German Ministry of Justice	http://www.bmj.bund.de/frames/eng/service/publications/10000413/index.html?sid=feefaa6cc81bf4ed9d67631a8a9cccd1
		DSW Guidelines	June 1998	Deutsche Schutzvereinigung für Wertpapierbesitz e.V.	Hard copy available from dsw@dsw-info.de
		German Code of Corporate Governance (GCCG)	June 2000	Berliner Initiativkreis	http://www.gccg.de/eng_German-Code-of-Corporate-Governance.pdf
		Corporate Governance Rules for German Quoted Companies	July 2000	German Panel on Corporate Governance www.dai.de	http://www.dai.de/internet/dai/dai-2-0.nsf/LookupDL/750A7D6555A4E001C1256B29005F520C/$File/code0700e.pdf
		Baums Commission Report	10 July 2001	N/A	http://www.ovs.de/corporate_governance.htm
		Cromme Code	26 February 2002	German Corporate Governance Kodex	http://www.corporate-governance-code.de/eng/download/DCG_K_E_old.pdf
		Amendments to the Cromme Code	21 May 2003	Government Commission German Corporate Governance Code	http://www.ecgi.de/codes/country_documents/germany/code_200305_en.pdf

14	Greece 	Principles on Corporate Governance in Greece: Recommendations for its Competitive Transformation	October 1999	Committee on Corporate Governance in Greece (under the coordination of the Capital Market Commission)	http://www.worldbank.org/html/fpd/privatesector/cg/docs/greece-engl.pdf
		Principles of Corporate Governance	24 July 2001	Federation of Greek Industries	http://www.ecgi.de/codes/country_documents/greece/wn_010724.pdf
15	Hong Kong 	Code of Best Practice	February 1999	Hong Kong Stock Exchange	http://www.ecgi.de/codes/country_documents/hong_kong/hk_app14.pdf
		Corporate Governance Disclosure in Annual Reports	March 2001	Hong Kong Society of Accountants www.hksa.org.hk	http://www.ifac.org/credibility/ViewPoints_PubDL.php?PubID=00040
		Model Code for Securities Transactions by Directors of Listed Companies: Basic Principles	June 2001	Hong Kong Stock Exchange	http://www.hkex.com.hk/rulereg/listrules/app10.doc
16	India  	Draft Report of the Kumar Mangalam Committee on Corporate Governance	Sep. 1999	Securities and Exchange Board of India (SEBI) www.sebi.gov.in	http://www.ecgn.ulb.ac.be/ecgn/docs/codes/india-corpgovern.html
		Desirable Corporate Governance in India - A Code	April 1998	Confederation of Indian Industry www.ciionline.org	By order, E-mail: ciigen.cii@axcess.net.in
		Report of the Kumar Mangalam Birla Committee on Corporate Governance	February 2000	Securities and Exchange Board of India (SEBI) www.sebi.gov.in	http://www.sebi.gov.in/commreport/corpgov.jsp
		The first principles of corporate governance for Public Enterprises in India	October 2001	SCOPE-YCPL	http://www.academyofcg.org/firstprinciples2.htm
17	Indonesia	Code for Good Corporate Governance	March 2000	The National Committee on Corporate Governance	http://www.ecgi.de/codes/country_documents/indonesia/ins_cgcg_may_2000.pdf

		Code for Good Corporate Governance	March 2001	The National Committee on Corporate Governance	On request from http://www.jsx.co.id/Default.asp?
18	Ireland	Corporate Governance, Share Option and Other Incentive Schemes	March 1999	Irish Association of Investment Managers www.iaim.ie	http://www.iaim.ie/guideline/guideline1.htm
19	Italy	Testo Unico sulle disponsizioni in materia di intermediazione	February 1998	Law Reform based on Draghi Proposals	http://www.ecgi.de/codes/country_documents/italy/testo_unico_eng.pdf
		Report & Code of Conduct ("Preda Code")	October 1999	Committee for the Corporate Governance of Listed Companies	http://www.borsaitalia.it/media/pdf/code_autodisc/cod_di_autoregol_ing.pdf
		Corporate Governance Code (il Codice di Autodisciplina delle società quotate rivisitato)	Revised July 2002	Committee for the Corporate Governance of Listed Companies, Borsa Italiana	http://www.ecgi.de/codes/country_documents/italy/code_it_jul2002_eng.pdf
20	Japan	Urgent Recommendations Concerning Corporate Governance	Sep. 1997	Japan Federation of Economic Organisations (Keidanren)	http://www.keidanren.or.jp/english/policy/pol067.html
		Corporate Governance Principles: A Japanese view	30 Oct. 1997	Corporate Governance Forum of Japan	http://www.ecgi.de/codes/country_documents/japan/japan_cgf_j.pdf
		Report of the Pension Fund Corporate Governance Research Committee, Action Guidelines for Exercising Voting Rights	June 1998	Pension Fund Association (Kosei Nenkin Kikin Rengokai)	From: Kosei Nenkin Kikin Rengokai: Tel. +81 [0]3/ 3597 0673, Fax +81 [0]3/ 3597 0754.
		Revised Corporate Governance Principles	26 Oct. 2001	Japan Corporate Governance Forum	http://www.ifac.org/credibility/ViewPoints_PubDL.php?PubID=00046
21	Kenya	Sample Code of Best Practice for Corporate Governance	N/A	Private Sector Corporate Governance Trust	http://www.corporategovernance.co.ke/principles/principles.htm

		Principles for Corporate Governance in Kenya	N/A	N/A	http://www.ecgi.de/codes/country_documents/kenya/principles_2.pdf
22	Korea 	Code of Best Practice for Corporate Governance	Sept. 1999	Committee on Corporate Governance	http://www.ecgi.de/codes/country_documents/korea/code_korea.pdf
23	Malaysia 	Malaysian Code on Corporate Governance	March 2000	Securities Commission Malaysia	http://www.ecgi.de/codes/country_documents/malaysia/mccg_mar2000.pdf
٢4	Macedonia 	White Paper on Corporate Governance in South-Eastern Europe (Macedonian Version)	July ٢٠٠٣	Macedonia Corporate Governance and Company Law Project www.maccorpgov.com.mk	http://www.ecgi.de/codes/country_documents/macedonia/white_paper_en.pdf
25	Malta 	Principles of Good Corporate Governance	1 October 2001	Malta Stock Exchange	Section1:http://www.borzamalta.com.mt/Corporate%20Governance/section1.htm Section2:http://www.borzamalta.com.mt/Corporate%20Governance/section2.htm
26	Mexico 	Código de Mejores Prácticas Corporativas	July 1999	Mexican Stock Exchange, the Mexican Bankers' Association, the Mexican Institute of Finance Executives and the Mexican Institute of Public Accountants	http://www.ecgi.de/codes/country_documents/mexico/mexico_code_en.pdf
27	The Netherlands 	Peters Report & Recommendations, Corporate Governance in the Netherlands	27 June 1997	Committee on Corporate Governance	http://www.cnmv.es/delfos/DOSSGM/CORPGOV/corpgh.pdf
		Government Governance; Corporate governance in the public sector, why and how?	2 November 2000	The Netherlands Ministry of Finance www.minfin.nl	http://www.minfin.nl/default.asp?CMS_TCP=tcpAsset&id=82127168D1B04FEC8C1CBC1D9E462B9F

		SCGOP Handbook of Corporate Governance	August 2001	The Foundation for Corporate Governance Research for Pension Funds (SCGOP) Stichting Corporate Governance Onderzoek voor Pensioenfonds en	http://www.scgop.nl/downloads/Handbook_SCGOP.pdf or http://www.ecgi.de/codes/country_documents/netherlands/handbook_scgop_en.pdf
		Draft Corporate Governance Code	1 July 2003	Corporate Governance Committee	http://corpgov.nl/page/downloads/Conceptcode%20Engels%20DEFINITIEF.pdf
28	Pakistan	Stock Exchange Code of Corporate Governance	4 March 2002	The Securities and Exchange Commission of Pakistan www.secp.gov.pk	http://www.ecgi.de/codes/country_documents/pakistan/directive_for_SE_for_compliance_final.pdf
		Code of Corporate Governance (Revised)	28 March 2002	The Securities and Exchange Commission of Pakistan	http://www.secp.gov.pk/news/code_corporate(revised).htm
		SEC- UNDP Project Report on Corporate Governance	July 2003	The Securities and Exchange Commission of Pakistan	http://www.secp.gov.pk/dp/pdf/ProjectReport.pdf
29	Pan-European	Corporate Governance in Europe	June 1995	Report of a CEPS Working Party	http://www.ecgi.de/codes/country_documents/pan_european/ceps_june1995.pdf
		Sound business standards and corporate practices: A set of guidelines	Septmber 1997	European Bank for Reconstruction and Development (EBRD)	http://www.ebrd.com/pubs/law/standard/stande.pdf
		Corporate Governance Guidelines 2000	February 2000	European Shareholders Association	http://www.wfic.org/esh/Guidelines.pdf
		EASD Principles and Recommendations	May 2000	European Association of Securities Dealers Corporate Governance Committee	http://www.easd.com/recommendations/rec0001.pdf OR: http://www.ecgi.de/codes/country_documents/pan_european/easd_cg_pr.pdf
30	Peru	Perú: Código de Buen Gobierno Corporativo para Empresas Emisoras de Valores	Nov. 2001	Centro de Estudios de Mercado de Capitales y Financiero www.mcfperu.org/	http://www.mcfperu.org/gobierno/download/codigocbgc2811011difusion.pdf

		Principios de Buen Gobierno para las Sociedades Peruanas	July 2002	Comisió Nacional Supervisora de Empresas y Valores "CONASEV"	http://www.mcfperu.org/gobierno/download/principios%20ocde%20espanol.pdf
31	Poland 	The Corporate Governance Code for Polish Listed Companies (final proposal)	June 2002	The Polish Corporate Governance Forum www.pfcg.org.pl/en/	http://www.ecgi.de/codes/country_documents/poland/code_final_complete.pdf
		Best Practices in Public Companies in 2002	4 July 2002	The Best Practices Committee at Corporate Governance Forum	http://www.ecgi.de/codes/country_documents/poland/practices_2002.pdf
32	Portugal 	Recommendations on Corporate Governance	December 2001	Comissão do Mercado de Valores Mobiliários www.cmvm.pt	http://www.cmvm.pt/english_pages/recomendacoes_e_orientacoes/recomendacoes/soccot/indice_soccot.asp
33	Romania 	Corporate Governance Initiative for Economic Democracy in Romania: Corporate Governance Code	24 June 2000	International Center for Entrepreneurial Studies, University of Bucharest	http://www.ecgi.de/codes/country_documents/romania/romania.pdf
		Corporate Governance Code in Romania	March 2000	Russian Institute of Directors	http://www.rid.ru/db.php?db_id=82&l=en
34	Russia 	The Russian Code of Corporate Conduct	4 April 2002	The Co-ordination Council for Corporate Governance	http://www.usrbc.org/Corp%20Governance/Corp.%20Governance-%20full%20text%20final.htm OR: http://www.ecgi.de/codes/country_documents/russia/final_code_english.pdf
35	Singapore 	Code of Corporate Governance	21 March 2001	Corporate Governance Committee, Council on Corporate Disclosure and Governance (CCDG)	http://www.ccdg.gov.sg/attachments/CodeofCorporateGovernance.doc
36	Slovakia 	Corporate Governance Code (Based on the OECD Principles)	Sep. 2002	Bratislava Stock Exchange www.bsse.sk	http://www.bsse.sk/Content/EN/Issuers/corp_gov/corp_gov_code.pdf?LANG=EN

37	South Africa	King I Report	24 Nov. 1994	The Institute of Directors of Southern Africa www.iodsa.co.za	http://www.worldbank.org/html/fpd/privatesector/cg/docs/king.pdf
		King Report on Corporate Governance for South Africa - 2002 (King II Report)	March 2002	The Institute of Directors of Southern Africa	http://www.ecgi.de/codes/country_documents/south_africa/executive_summary.pdf
38	Spain	Círculo de Empresarios	October 1996	N/A	http://www.ecgi.de/codes/country_documents/spain/empres.pdf (Spanish)
		Código de Buen Gobierno	Feb. 1998	Special Commission to Consider a Code of Ethics for Companies' Boards of Directors appointed by the Spanish Cabinet	http://www.worldbank.org/html/fpd/privatesector/cg/docs/spain-circulo%20de%20empres.pdf
		The Aldama report - Informe de la Comisión Especial para el Fomento de la Transparencia y Seguridad en los Mercados y en las Sociedades Cotizadas	8 January 2003	Report by a Special Commission chaired by Enrique de Aldama y Miñón to foster transparency and security in the markets and in listed companies	http://www.ecgi.de/codes/country_documents/spain/informefinal_e.pdf
39	Sweden	Corporate Governance Policy – guidelines for better control and transparency for owners of companies quoted on the Swedish stockmarket	26th October 2001	Sveriges Aktiesparares Riksförbund (The Swedish Shareholders' Association) www.aktiespararna.se	http://www.ecgi.de/codes/country_documents/sweden/corporate_governance_policy0201.pdf
40	Switzerland	Directive on Information Relating to Corporate Governance: Corporate Governance Directive (DCG)	1 July 2002	SWX Swiss Exchange www.swx.com	http://www.swx.com/admission/rlcg_en.pdf

		Corporate Governance: Swiss Code of Best Practice (SCBP)	25 July 2002	Swiss Business Federation www.economiesuisse.ch	http://www2.economiesuisse.ch/d/content.cfm?upid=DD23731B-DCDF-4F99-960C0AE389A96E3C&type=pdf&filetype=pdf

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