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Ownership of local corporations and audit committee diligence: An empirical evidence from an emerging economy

Khaled Salmen Aljaaidi[a*]

[a]*Assistant Professor, Accounting Department, College of Business Administration, Prince Sattam bin Abdulaziz University, Saudi Arabia*

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A B S T R A C T

This study examines whether local corporate ownership is associated with audit committee diligence among 431 listed manufactured firms in Saudi Stock Exchange (Tadawul) for the period 2012-2019. Using the complementary hypothesis, this study expected that there is a positive relationship between local corporate ownership and audit committee diligence. The Pooled OLS regression shows that local corporate ownership is positively associated with audit committee diligence. The findings reported by this study have implications for regulators, companies' management, auditors, and creditors in a manner that they would gain a deeper understanding on how the local corporate ownership impacts the audit committee diligence.

1. Introduction

The need for corporate governance is as a result of the possibility of the interests of various stakeholders conflicting. The common term used for such conflicts of interests across the corporate structure is agency problems. Agency problems have two main sources which include, difference in preferences and goals among stakeholders and stakeholders not clearly knowing each other's preferences, knowledge and actions (Gillan & Starks, 2003). It is mandatory for corporations to have audit committees since many large companies have collapsed over years. Majority of the collapses are widely as a result of absence of effective corporate governance (Leung & Cooper, 2003). The Saudi Corporate Governance Code designates the audit committee as one of the most crucial mechanisms for internal governance. In numerous previous studies, how many diligences an audit committee holds over a certain period of time shows its effectiveness but it can also measure its meticulousness (Kyereboah-Coleman, 2007; Mohid Rahmat et al., 2009). The rate of occurrence of the audit committee diligence can be instigated as a means to ensure the committee's aptitude. In some entrenched corporations the frequency of the diligence can also be used to keep an eye on the benefits of financial reporting of the company (DeZoort et al., 2002). The activeness of an audit committee is measured by its ability to send out a positive signal regarding how good the financial information of a company is, especially where sizable agency costs are involved (Dey, 2008). Previous literature on issues of an audit committee describes an effective audit committee as one that guarantees efficient risk management, proper in-house control, and precise financial reporting for that particular organization. Additionally, an active audit committee promotes transparent security markets which in turn improve the book value of a company and protects the interests of shareholders (Astuti, Fachrurrozie, Amal & Zahra, 2020; Rahman, Meah &

* Corresponding author. Tel: +966 503831531
E-mail address: k.aljaaidi@psau.edu.sa (K. S. Aljaaidi)

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Chaudhory, 2019; Yin et al., 2012; McMullen & Raghunandam, 1996; DeZoort et al., 2002; Bagais & Aljaaidi, 2020; Habtoor, Hassan & Aljaaidi, 2019; Hassan, Aljaaidi, Abidin and Nasser, 2018).

This study is aimed at testing the relationship between audit committee diligence and local company ownership. Specifically, in many emerging countries local companies are amongst the prevalent group of block-holders (Claessens et al., 2000). Corporate ownership is quite beneficial to inter-corporation alliances since it saves them money by decreasing the monitoring costs of the associations or endeavors between businesses and their corporate block holders (Allen and Phillips, 2000). It also points out that local investors provide more financial, organizational, and technical resources than foreign investors (Chibber & Majumdar, 1999; Djankov & Hoekman, 2000; Khanna & Palepu, 2000). In addition, the local trade and administrative ties are usually the influencers of the monitoring roles played by local investors (Claessens et al., 2000; Dharwadkar, George & Brandes, 2000; Douma et al., 2006).

Saudi Arabia offers fundamental equity ownership to local organizations. The local corporations are often allowed to designate members who act as representatives in the board of directors of organizations that disclose to them internal information. These representatives are called insiders. Dominance over local companies affects corporate governance practice along with the management of companies since it denies managers the supple independence and the objective to keep the internal processes of a company in check. Additionally, a corporate governance structure dominated by local corporate ownership is more preferable to investors due to deficiency of robust protection on investor and more so, Saudi Arabia faces underdevelopment in the corporate control market (Chahine & Tohme, 2009; Alsaeed, 2006; Al-Shammari et al., 2008; Omran et al., 2008). A study by Chahine (2007) indicates that corporations within the Gulf Cooperation Council (GCC), are likely to have poor decision-making processes and erroneous communication dominating how board members play their administrative role since the board members rely and associate strongly with the owners.

This study uses the complementary hypothesis to predict the relationship between the local corporate ownership and audit committee diligence, expecting that local corporate ownership is interrelated with an audit committee meeting. The corporate governance mechanisms, namely; the ownership of local companies and audit committee diligence become more effective when they are combined together. O'Sullivan et al. (2008) and Hassan et al. (2017) indicated that examining the corporate governance mechanisms as an overall and not individually gives a stronger effect. As a consequence, the shareholder interests are protected because these governance mechanisms act in a complementary or substitutable fashion (Ward et al., 2009; Agrawal and Knoeber, 1996; Omer et al., 2020). Empirically, a few studies that have investigated the determinants of audit committee meeting (Aljaaidi, Bagais & Adow, 2021; Aljaaidi, Sharma & Bagais, 2021; Aljaaidi & Bagais, 2021; Menon & Williams, 1994; Mendez & Garcia, 2007; Raghunandan & Rama, 2007; Sharma et al., 2009; Greco, 2011; Al-Najjar, 2011; Thiruvadi, 2012; Yin et al., 2012; Maraghni and Nekhili, 2014; Braswell, Daniels, Landis & Chang, 2012). The studies used in this paper were carried out in various developed and developing countries due to lack of enough evidence from Saudi Arabia. Moreover, most of the results from the studies were contradictory and lacking, bringing about the need for further empirical inquiries on issues pertaining to the meticulousness of the audit committees. The researcher utilized various resources but found no existence of literature on impacts of local corporate ownership on audit committee diligence. Therefore, this study contributes to the corporate governance literature by incorporating recent data as an extension of the existing research on rate of recurrence of the audit committee diligence.

The remainder of the paper is organized as follows. The next section describes the sample, data and model of the study. Fourth section presents the results, tests and analysis. The final section concludes the study.

2. Research design and model specification

The population relevant to the study is all the manufacturing companies listed on the Saudi Stock Exchange (Tadawul) for the years 2012-2019. A cross sectional review of audit reports of the sampled companies listed on Tadawul was undertaken. Samples selected are depicted in Table 1.

Table 1
Sample Selection

	Total Observations
Total observations	465
Observations discarded (outliers, missing and incomplete data)	(34)
Final sample	431

The model of this study uses four control variables; board meeting, firm performance, leverage, and firm size. The extant research indicated that these control variables are associated with corporate governance structure. The previous studies pointed out to a positive relationship between board meetings and audit committee meetings (Maraghni & Nekhili, 2014; Thiruvadi, 2012; Raghunandan & Rama, 2007). It was reported that there is a negative relationship between firm performance and audit committee meetings (Raghunandan and Rama, 2007; Sharma et al., 2009; Yin et al., 2012; Qasim, 2020). In addition, it is documentd that there is a negative association between firm leverage and audit committee meetings (Yin et al., 2012; Me´ndez and Garcı´a, 2007). Further, prior research indicated a positive relationship between firm size and audit committee meeting (Yin et al., 2012; Raghunandan & Rama, 2007; Me´ndez & Garcı´a, 2007; Deli & Gillan 2000; Sharma et al. 2009; Maraghni and Nekhili, 2014; Qasim, 2020; Braswell et al., 2012). Due to the continuous nature of the dependent variable, Pooled Ordinary Least Square OLS was utilized as the method of analysis to test the hypothesis. The OLS model can be formulated as following:

$$ACDIL = \beta_0 + \beta_1\, DCOWN + \beta_2\, BDMEET + \beta_3\, ROA + \beta_4\, LEV + \beta_5\, FSIZE + e \quad (1)$$

where

ACDIL	=	Number of meetings held during the year
DCOWN	=	Percentage of common shares held by local companies
BDMEET	=	Number of board meetings held during the year
ROA	=	Return on assets
LEV	=	Total book value of debt to total assets ratio
FSIZE	=	Log_{10} of total assets
e	=	error term.

As for the measurements of the variables, Table 2 exhibits the dependent and test variables.

Table 2

Summary of the Operationalization of the Research Variables

Variables	Acronym	Operationalization	Type of variable
Dependent Variable			
Audit committee activity	*ACDIL*	Number of meetings held during the year	d.v
Hypothesized variable			
Local companies' ownership	DCOWN	Percentage of common shares held by local firms	i.v
Control variables			
Board meeting	BDMEET	Number of meetings held during the year	i.v
Firm performance	ROA	Return on assets	i.v
Firm leverage	LEV	Total book value of debt to total assets ratio	i.v
Firm size	FSIZE	Log_{10} of total assets	

Note: d.v – dependent variable, i.v – independent variable

3. Results and discussions

3.1 Descriptive statistics and correlation analysis

The descriptive statistics are presented in Table 3, showing the mean, standard deviation, minimum and maximum of each variable in the sample data set.

Table 3

Descriptive statistics

.	Minimum	Maximum	Mean	Std.Deviation
DCOWN	.00	.880	.18604	2.14453
ACDIL	2	12	5	1.55894
BDMEET	2	22	5	2.14453
ROA	-.51	1.00	.5062	.32358
LEV	.00	.86	.2670	.20453
FSIZE	35461604	340041000000	13519849111	45180718146

Table 3 displays that there is a significant range of variation among the considered samples of this study. Table 3 shows that the range of DCOWN ranges from .00 to .880 with a mean of .18604 and a standard deviation of 2.14453. ACDIL is from 2 to 12 with an average of 5 and a standard deviation of 1.55894. The mean of BDMEET is 5 and it ranges from 2 to 22 and a standard deviation of 2.14453. The ROA ranges from -.51 to 1.00 with an average of .5062 and a standard deviation of .32358. As for the LEV, the mean is .2670 and it ranges from .00 to .86 and a standard deviation of .20453. The FSIZE ranges from 35461604 to 340041000000 with an average of 13519849111 and a standard deviation of 45180718146.

Table 4
Correlation matrix of independent variables

	DCOWN	BDMEET	ROA	LEV	FSIZE
DCOWN	1				
BDMEET	.184**	1			
ROA	-.155*	.058	1		
LEV	.041	-.078	-.739**	1	
FSIZE	.341**	-.012	-.516**	.369**	1

Table 4 confirms that the multicollinearity problem does not exist because the correlation matrixes among the variables do not exceed 0.90. All the variables have a correlation of equal to or less than .739.

3.2 Multivariate analysis

Table 5
Audit committee diligence regression model

Variables	Expected Sign	Coef.	*t*	*P*> |t|
Hypothesized Variable				
DCOWN	+	1.422	2.358	**.019**
Control variables				
BDMEET		.288	6.297	**.001**
ROA		-1.368	-2.243	**.026**
LEV		-.878	-1.023	**.307**
FSIZE		-.704	-3.185	**.002**

F	*11.64*
Adjusted R^2	*20.3*
P-value	*0.001*

Bold = significance at 1%, 5% and 10% (two-tailed significance)

Table 5 reports the multiple regression results. As shown from Table 5, the model explains 20.3% of the variation in the audit committee diligence. The model is significant (F = 11.4) and (Sign F = 0.001). as for the association between local corporate ownership and audit committee diligence, the direction of this relationship is positive and significant in the predicted direction at 1% (β = 1.422, t = 2.358, P = .019, one-tailed significance). This result gives support to the complementary hypothesis. This indicates that local corporate ownership as a governance monitoring mechanism becomes more effective through mutual enhancement and the synergistic effects when it is combined with audit committee diligence as another governance monitoring mechanism. In addition, the effectiveness of local corporate ownership as a monitoring mechanism depends on the effectiveness of the audit committee.

4. Summary and conclusion

The primary objective of this study was to examine empirically whether local corporate ownership impacts the audit committee diligence among 431 Saudi manufactured corporations listed on Saudi Stock Exchange (Tadawul) for the period 2012-2019. This study reports that local corporate ownership is positively associated with audit committee diligence. This result is concurrent with the earlier predicted hypothesis which points out that the effectiveness of the local corporate ownership is complimented by audit committee diligence as an additional governance monitoring mechanism. Therefore, the two governance monitoring mechanisms are often interdependent. Therefore, this study provides an additional empirical evidence to the literature body of corporate governance.

This study is important since it unveils the correlation between audit committee diligences and local corporate ownership in Saudi Arabia. The country's regulators can utilize the findings of this study to introduce protocols that can promote better corporate governance practices. Various limitations were encountered while conducting this study. The main limitation was that the data used was from Saudi Arabia hence generalization of findings to other markets must be cautious due to variation in regulations and economic physiognomies. This study creates a baseline for researchers interested in other classifications of ownership such as institutional, governmental and family ownership. Moreover, Additional research may also be based on other audit committee features such as financial expertise, their independence, or committee size. Furthermore, the setting of the research must not be necessarily Saudi Arabia. The study can be replicated to contexts of other countries within the GCC.

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