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Board interlocking and firm performance: the role of foreign ownership in Saudi Arabia

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Abstract

Purpose – The purpose of this paper is to investigate what effect, if any, foreign ownership has on the relationship between board interlocking and firm performance.

Design/methodology/approach – Data on 131 firms from various sectors listed in the Saudi Financial Market during the period of 2016 were collected. Board interlocking was measured using two indicators (number of interlocks and number of interlocks per member) and then it was divided into three levels (1-6/7-14/15 or more). As for the performance of firms, it was measured using two indicators: one operational (return on assets and the other financial (return on equity)). Foreign ownership was considered as a moderator variable. In addition to firm and board characteristics, a set of control variables related to ownership structure was used.

Findings – Results provide some support for the "busyness hypothesis" which postulates deterioration in the effectiveness of directors, in terms of their monitoring role, when increasing the number of interlocks per director. Results also manifest a positive effect exerted by foreign ownership in terms of turning around the otherwise negative relationship between board interlocking and firm performance in the second level of interlocking (7-14) Code Article 12's limit on the number of interlocking per director to a maximum of five directorships. However, there is limited compliance to this code among Saudi firms. The study indicates the need to comply with the governance code in order to enhance governance which undercut performance.

Originality/value – Highlighting the role of foreign ownership in enhancing corporate governance in a conservative business environment characterized by relational networks with gaps in corporate governance.

Keywords Firm performance, Independent directors, Corporate governance, Emerging markets, Foreign ownership, Saudi financial market, Board interlocking

Paper type Research paper