Corporate governance, disclosure quality and financial performance: A comparative study of corporate firms in Saudi Arabia and Australia

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Abstract

This proposal is for a comparative study between companies of Saudi Arabia and Australia, examining the influence of corporate governance in both disclosure quality and financial performance. The study is designed to fill the gap in the literature by providing empirical support for recent arguments that corporate governance is related to financial performance and disclosure quality. This proposal thus develops two main hypotheses which will be measured and tested over the course of the study. The proposed method for testing the hypotheses is through simple and multiple linear regression analyses of data extracted from the financial statements of 200 companies, 100 from each country. This data will be supported by additional information from market reports and industry analysis where available and relevant.

Introduction

The last decade has seen significant global instability in capital markets. This has particularity been the case in countries which have low or limited governance instruments in place to protect shareholder and manage risk. This study proposes that there are higher standards of governance in economically strong, well developed and regulated markets which is absent in developing countries. This is reflected in the quality of disclosure in financial performance of the companies, will developing countries performing higher in financial performance and disclosure quality.

Keong (2002) argued that corporate governance within a particular country is a reflection of the history, culture, regulatory structures and market characteristics. In this research project two distinct cultural and legal setting for governance will be compared. Australia is a developed financial democracy based upon common Law and the Westminster system of government. The Australian Stock Exchange (ASX, 2010) has issues a set of recommendation and regulations for corporate governance behaviour. These recommendations on corporate governance seek to influences how the objectives of corporate governance within the company are set and achieved, how risk is monitored and assessed, and how performance is optimised.

In contrast, Saudi Arabia is a developing Monarchy in which operates under Sharia systems (*Islamic Law*) of legal and administrative law, has no corporate governance regulations or national recommendations (Al-Turki, 2006). There are no formal regulations for corporate governance in Saudi Arabia before 2006. The objective of this study is to investigate the effects of corporate governance on financial performance and disclosure quality in Saudi Arabia and Australia.

Statement of the Problem

This research seeks to explore the effects of corporate governance mechanism between Australia and Saudi Arabia. In Saudi Arabia which has a developing regulatory market, there is a lack of empirical evidence for the effect on corporate governance of disclosure quality and final performance in companies. In contrast,

Australia is a well-developed country with strong regulation and corporate codes of conduct. Choi (2011) and Carver (2010) have argued that modern corporate governance research is excessively focused on the impact of single variables on governance outcomes, rather than the consideration of broader impacts and relationships. Whilst these arguments are persuasive, they are largely rooted in theoretical concepts and subjective arguments, and do not incorporate empirical justification. As such, there is a gap in the literature to carry out empirical research in the area, and contribute to overall understanding of the corporate governance system.

Significance and Motivation of the Study

Saudi Arabia is a country undergoing significant change in the approach the government is taking towards corporate governance and compliance. This is reflected in the recent intergeneration of the International Accounting Standards. These standards provide a framework for comparing financial records based on the homogenisation of accounting standards between jurisdictions. This study has significance as it informs on the impact of non-governance regulated listed companies in Saudi Arabia, and compares these with Australia which has a well-developed set of corporate governance principles.

Objectives of the Study

The main objective of this study is to investigate the influence of corporate governance mechanisms on financial performance and disclosure quality in listed companies at Australian Security Exchange (ASX) and Capital Market Authority of Saudi Arabia (CMA)/ Saudi Stock Market. Investigation of this key objective will be achieved through different lines of enquiry which will involve:

I. Exploring the corporate governance practices in listed companies of Saudi Arabia and Australia.

II. Testing the effect corporate governance on financial performance in both countries.

III. Exploring the influence of corporate governance on disclosure quality in Australia and Saudi Arabia companies.

Research Questions and Hypothesis

Australia and Saudi Arabia have variations in the level and period of implementation of corporate regulations, (Ball *et al.,* 2002, Bradshaw and Miller, 2002). This difference may have impact on financial performance as a consequence of differences in corporate governance and the quality of disclosure in financial reports level of governance. The main questions that form the basis of this thesis are therefore:

Research Question 1: What is the effect of corporate governance on disclosure quality in companies in Saudi Arabia and Australia?

Research Question 2: What is the influence of corporate governance on the financial performance of companies in Saudi Arabia and Australia?

Main Hypotheses

H1. The corporate governance has a positive influence on disclosure quality

Disclosure Quality = $\beta 0$ +$\beta 1$*Corporate governance variables relating to (ownership, board of directors, audit committee, external audit) +*
$\beta 4$ other firm specific control variables + $\beta 5$ industry dummies
+ $\beta 6$ year dummies + μ

In equation one, disclosure quality is the dependant variable measuring by Earning Response Coefficient (ERC) as a proxy for disclosure quality and Earning Quality as well. Corporate governance is the independent variable. In order to measure corporate governance the following measures will be used (ownership, board of directors, audit committee and external audit) and asymmetry is the reporting of results. And μ is the random error.

H2. The corporate governance has a positive impact on financial performance

Financial Performance = $\beta 0$ +$\beta 1$*Corporate governance variables relating to (ownership, board of directors, CEO duality and audit committee) + $\beta 4$ other firm specific control variables +*
$\beta 5$ industry dummies + $\beta 6$ year dummies + μ

In equation two, financial performance is the dependant variable measuring by Return on investment (ROI), Return on Asset (ROA), Return on Equality (ROE) and Tobin's Q. Corporate governance is the independent variable. In order to measure corporate governance the following measures will be used (ownership, board of directors, CEO duality and audit committee) and asymmetry is the reporting of results. μ is the random error.

Literature Review

Corporate Governance

Corporate governance is the system by which companies are directed and controlled (Brown, 2011). Corporate governance levels are reflected gearing with shareholder equity should be greater than the long term liabilities (Leal and Carvalhal-da Silva, 2005). Corporate governance is linked to the total return on assets and reflects the efficiency of converting assets into value for shareholders (Beiner and Schmid, 2005). This is a reflection of the role governance as it corrects the value of the firm and a positive relationship between the value of firm and the price to book value increases investor confidence (Leal and Carvalhal-da Silva, 2005).

The Corporate governance practice was not prevalent before the 21st century, However this practice is now thought to play an important part of the success of any commercial organisation (Nowroozi, 2002). This can be noted from the several corporate failures that took place in the recent past. Considering the example of Enron, the US based market leader in energy based industry, it can be seen that the organization had suddenly fell in the end of the year 2001 and the company was declared bankrupt by December 2001 (Nowroozi, 2002; Vinten, 2005). The major cause of failure seems to be due to the highly risky accounting policies incorporated by the organization. The organization offered lavish compensation to the staff, and had not covered all the business activities on their books. The board seemed to be misguided by the auditors or management of the organization, resulting in huge failure.

Similarly, WorldCom the 2nd biggest telecommunications organization had suffered huge bankruptcy in the year 2002, when a huge set of irregularities were found in its

accounting statements (Thornburgh, 2004). The top management formulated business policies of their interest, which disrupted the actual accounting policies resulting in a huge failure of the entire organization (Lopes and Walker, 2012). Besides these, Health-South, Global Crossing, Tyco too were some of the organizations that had suffered complete failure due to the mismanagement of their corporate governance policies (Anon, 2005). However, following Sarbanes-Oxley Act can be of great help for the organizations to ensure that their corporate governance policies are in line with their desired outcomes for successful performance of the organization.

The below stated are the important principles of Corporate Governance (Mallin, 2007; Anon, 2012):-

- **Transparency**: There should be transparency in the business policies of the organization amongst management level as well as board members.
- **Accountability**: The actions carried out by an organization should be accountable with a clear description of their actions and the appropriate focus on accounting policies.
- **Probity**: The individuals associated with an organization should work honestly without hiding any detail with each other.
- **Equity**: The top management should not be biased towards any particular individual and in turn the department should be fair towards all employees.

Corporate Governance in Australia

In Australia the Corporations Act 2007 contained regulations against misconduct by directors and managers this provides a frame work for the regulation of companies. While not legally binding the ASX (2010, p. 3) has published a set of eight amended principles of corporate governance 'intended to provide a reference point for companies about their corporate governance structures and practices':

> Principle 1 – Lay solid foundations for management and oversight: Companies should establish and disclose the respective roles and responsibilities of board and management (ASX 2010, p. 13).
>
> Principle 2 - Structure the board to add value: Companies should have a board of an effective composition, size and commitment to adequately discharge its responsibilities and duties (ASX 2010, p. 16).
>
> Principle 3 - Promote ethical and responsible decision-making: Companies should actively promote ethical and responsible decision-making (ASX, 2010, p. 22).
>
> Principle 4 - Safeguard integrity in financial reporting: Companies should have a structure to independently verify and safeguard the integrity of their financial reporting (ASX, 2010, p. 26.
>
> Principle 5 - Make timely and balanced disclosure: Companies should promote timely and balanced disclosure of all material matters concerning the company (ASX, 2010, p. 29).
>
> Principle 6 - Respect the rights of shareholders: Companies should respect the rights of shareholders and facilitate the effective exercise of those rights (ASX 2010, p. 31).
>
> Principle 7- Recognise and manage risk: Companies should establish a sound system of risk oversight and management and internal control (ASX 2010, p. 33).

Principle 8- Remunerate fairly and responsibly: Companies should ensure that the level and composition of remuneration is sufficient and reasonable and that its relationship to performance is clear (ASX 2010, p. 36).

These principles need to be applied by the companies as part of the listing requirements for the stock exchange. Companies are scrutinised by governments, media and the exchange to ensure compliance.

Corporate Governance in Saudi Arabia

In 2006 Saudi Arabia adopted corporate governance but became compulsory in 2010 to all listed companies. Corporate governance practices in Saudi Arabia are governed by three government bodies: The Ministry of Commerce, the Saudi Arabian Monetary Agency, and The Saudi Stock Exchange. There are a set of regulatory structures that seen to protect shareholder interest and govern ownership of companies. While the government has in place regulations to reporting, there is no requirement for external auditors. Also, many companies are dominated by family groups and this translates into board and senior executive position, and has effectively reduced the call for, and acceptance of, corporate governance standards in Saudi Arabia (Al-Turki, 2006).

Corporate Governance in Saudi Arabia is primarily only regulated in terms of accounting practices. The Saudi Arabian *Accountancy Law*, enacted by Royal Decree No. 43(1974), established the regulatory framework for the legal standards for auditors and accountants and the legal ramifications for misconduct (Naser and Nuseibeh, 2003). There is some disclosure in Saudi Arabia with companies disclosing more information than is legally required. However this it seems is still relatively low as compared to more developed in terms of more developed counties such as Australia (Naser and Nuseibeh, 2003). In addition, The Capital Market Authority (CMA) which in Saudi Arabia is the party responsible for the imposition of control and corporate governance, have set many regulation list of applying the corporate governance.

Corporate Governance and Disclosure Quality

One of the main issues considered in the corporate governance literature is the extent to which disclosures are influenced by governance, and the role of corporate governance reporting in ensuring high quality disclosures (Eng and Mak, 2003). In this area, Quick and Weimann (2011) examines the case of Germany, where the German Corporate Governance Code, GCGC, recommends that companies publish a separate corporate governance report as part of the annual report. The results of this study, based on the GCGC, show that the decision whether or not to publish a separate corporate governance report is a key driver of overall governance quality in the German case.

Another critical variable which is considered in the literature is the extent to which disclosure quality is linked to managerial incentives. This is of importance in corporate governance, due to the role of managerial incentives in combating agency issues and resolving agency conflicts (Peterson and Plenborg, 2006). According to Rogers (2008) there is evidence that managers strategically alter the quality of their disclosures when they have an incentive to do so. Market liquidity changes may act as a proxy for disclosure quality as managers provide higher quality disclosures before they sell any shares, to avoid investigations, and lower quality disclosures before buying shares to maintain their information advantage.

Other studies in this area have made more general examinations of the factors which influence disclosure quality. For example, Karamanou and Vafeas (2005) demonstrated that the quality of statutory executive stock option disclosures by listed companies in Australia over a three year period indicated that levels of board and committee independence and effectiveness helps improve overall levels of disclosure quality. This includes the audit committee, which is in line with the arguments of Nelson *et al.* (2010) the quality of the audit committee, and hence the audit function, is also associated with improved disclosure. Another study in this area, which covers the case of chief executive officer remuneration disclosure in Australia, again supported the argument that audit committee quality is positively linked to disclosure quality (Clarkson *et al.*, 2006).

Corporate governance is also associated with safeguarding and controlling the interests of organisational stakeholders (Morin and Jarrell, 2001). It also leads to increases in financial performance through the regulation of managers, CEO and other operational stakeholders (Monks and Minow, 2001). Higher rates of disclose lead to strong levels of corporate governance and this disclosure is often a function of legal responsibility (Rashid, 2008). There is a higher level of governance in developed countries in comparison to developing countries as a consequence of the increased strengthening of corporate laws and regulation in the developed countries (Nam and Nam, 2004). Investment is higher in firms in developed countries with a higher level of corporate governance because there is greater transparency and value creation within firms (Morin and Jarrell, 2001). Furthermore, the duality of combining the CEO and Chairman position has implications for removal by the board of directors in cases of under-performance and governance failure (White and Ingrassia, 1992). Thus increased governance is linked to higher value of the organisation and to lower gearing and risk (Rashid, 2008).

High quality disclosure in financial reports results in a high investor confidence in the financial reporting (Levitt, 1998). Disclosure can be measured as a function of accruals (Bradshaw *et al.*, 1999), or earning management and its impact on share price (Lang *et al.,* 2003). Disclosure is also associated with the measure of timeliness, or the current period accounting as a reflection of reporting economic and accounting income (Lang *et al.*, 2003). There are three attributes to determine the quality of financial reports in relation to disclosure: transparency, full disclosure and comparability (Pownall and Schipper, 1999). Transparency deals with the explanation of events, transactions, judgements and estimates that underpin the final statements. Full disclosure is a measure of the information provided that allows for informed decision making. Comparability is a measure of the uniformity of accounting processes that deal with similar transactions through time.

Information disclosure of accounting principles is contained in the supplementary notes of final statements and this information allows for the determination if an element of the financial reports meets a particular definition, and this information allows for information asymmetry (Hope, 2003). There are standards for definitions and accounting standards which are guided by national standards and these govern the accounting principles that are applicable in each jurisdiction. In order that the financial standards set down by regulators are met, and thus have meaning, there needs to be enforcement, and this enforcement can lead to high quality reporting and therefore disclosure (Hope, 2003). Studies have indicated that the level of compliance with national accounting standards in countries with limited enforcement is low (Bradshaw and Miller, 2002).

There is a relationship between the accounting standards which form the basis on which financial statements are prepared and the organisational incentives, such as results based bonuses or renewal of contacts, offered to auditors and managers for optimistic reporting (Ball *et al.*, 2002). Even though there is a high degree of transparency standards, the actual reports may be of a lower standard due to the political influences that are behind the organisation (Ball *et al.,* 2002). Therefore, the investor demands for returns and the higher economic performance benefits for managers may lead managers to withhold value-relevant unfavourable information,

and this may be sanctioned by the politicians which dictate policy (Sengupta, 1998). Market orientated counties have a higher rate of transparency than countries with planning orientated and political institution of governance dominated by familial connections (Ball *et al.,* 2002). This is reflected in the fact that insider trading is reduced in companies with high disclosure (Heflin *et al.* 2001).

The higher the quality of disclosure the greater the investor welfare which encourages higher capital inflow (Sengupta,1998). In cases of low disclosure investors demand higher rates of return in exchange for tolerating lower rates of disclosure (Miller, 2001). However, increased disclosure enables investors to the make more informed value judgements of a company's value (Preiffer, 1998). The use of annual reports and quarterly reports enables the evaluation of disclosure quality (Bushee and Noe, 2000). Also, stock volatility and institutional ownership composition are affected by disclosure rates with higher institutional ownership and lower volatility with greater disclosure (Bushee and Noe, 2000). Another benefit to higher disclose and capital raising is that the cost of debt is lower in companies with higher disclosure rates as underwriters seek clarity in detail in financial reports to assess risk (Sengupta, 1998).

Corporate Governance and Financial Performance

Financial performance is related to the size, with smaller companies able to utilise assets with greater effectiveness (Rashid, 2008). Joshi found in his study of corporate governance within an institution that the ability to utilise assets to generate income is dependent on the level of corporate governance and that the institution's performance was significantly variable between differing sectors (Joshi, 2011)

. Financial performance was significantly variable between differing sectors (Joshi, 2011). Tobin's Q is the ratio of the stock market valuation of firms to their "replacement" costs (Darity, 2008). Financial performance is linked to the concept of turnover value reflects the use of assets (Eng and Mak, 2003). Financial performance has been studied in terms of the ability to translate sales into profits (Eng and Mak, 2003). The valuations with financial statements of the firm are a reflection of the level of corporate governance within that firm (Rashid, 2008; Beiner and Schmid, 2005). The size of a firm is constantly been determined to relate to the level of disclosure (Knoff *et al*., 2002) and the use of net sales as an indicator of size of an organisation (Wallace *et al.,* 1994). Market value of common equity is a measure that has been used to determine the size of firms (Knoff *et al*., 2002). The use of total assets has also been used as it is not affected by significant market fluctuations (Malone *et al*., 1993). This study will use the log of the assets to measure size after Malone *et al.* (1993). The performance of a firm is also linked to the level of disclosure (Ali *et al.,* 2003). The performance can be measured using the profitability of organisation represented by the earning before tax by the total assets (Wallace *et al.,* 1994). The Price earnings ratio is also another measure of profitability and is determined by dividing the earnings before extraordinary items per share. This study will use the price earnings ratio and profitability to determine performance.

Corporate Governance Mechanism and Disclosure

Ownership Structure

One of the significant controls on the overall disclosure quality within an organisation is ownership structure (Brown *et al.,* 2011). In particular, Hutton (2007) showed that firms with higher levels of ownership concentration tended to provide a lower level of quality of disclosures. Brown *et al.* (2011) argued that the link between ownership concentration and disclosure quality is also shown in emerging markets, with Laidroo (2009, p. 13) studying the issue "in the context of three European

emerging capital markets in the Baltics – the Tallinn, Riga, and Vilnius Stock Exchanges". The results of this study showed that ownership concentration was negatively correlated with public announcement disclosure quality, with higher levels of concentration causing managers to deal directly with large owners rather than through the disclosure channel. This issue will thus need to be investigated in greater levels of detail.

Ownership concentration is another area found to have a strong correlation with corporate governance outcomes. For example, Cheung *et al.* (2010, p. 403) used data from a three year period covering Hong Kong firms to demonstrate that "family firms and firms with concentrated ownership structures are associated with bad corporate governance", thus obtaining significantly lower stock returns and higher levels of risk compared to their peers. Similarly, Sami *et al.* (2011) carried out a similar study in the Chinese context, demonstrating that ownership concentration in this context was also negatively correlated to corporate governance standards, and to firm performance. This has implications for countries like Saudi Arabia with high concentrations of ownership and limited governance. Cross ownership is also a governance issue for corporations as this allows the election of directors that are not necessary going to act in the best interest of the other shareholders (Brown 2011).

Further studies in this area have focused on the role of shareholder rights in the operating performance of a company. However, according to Gompers *et al.* (2003, p. 107) "shareholder rights can have both negative and positive effects on a firm's operating performance" under different circumstances. In particular, excessively weak shareholder rights tend to reduce monitoring effectiveness. Empirical investigation of shareholder rights by Core *et al.* (2006) showed that whilst firms with weak rights have on average lower operating performance, higher levels of shareholder rights can also harm performance. This implies there is a non-linear relationship between shareholder rights and performance, potentially a second order relationship.

Board of Directors

There are two types of directors which can affect the disclosure and governance practices dictated by the board: independent- unbiased director from outside the firm and act as referee between insider directors and stakeholders; and insider directors who have an interest in the company and typically represent the interests of majority shareholders (Bhagat and Black, 2002). According to Bauer *et al.* (2004) board structure, and particularly compliance with best practice with regards to board structure, is a strong driver of corporate financial performance.

The number of independent directors can influence the performance and safe guard minority shareholders (Joshi, 2011). The Board of Directors has fiduciary duties to the company shareholders and regulators (Gompers *et al.,* 2003). Thus the board is accountable to the shareholders, but in developing countries, such as Saudi Arabia, many board executive directors are the majority shareholders (Tomasic and Bottomley, 1993). The independence of non-executive directors is necessary to obtain efficient monitoring of the company (Brown 2011).

The Size of the Board

The size of the board can affect decision making processes and affects the value creation within the organisation (Kyereboah-Coleman and Biekpe, 2005).The size of the board influences the ability for the CEO or a single member to manipulate the decision making process (Rashid, 2008). A code of conduct is critical to maintaining board of director confidence (Joshi, 2011). The statement of a company's code of governance and philosophy increases share holder confidence and value adds to the firm. Eisenburg (1998) claims that governance improves when there are over seven members. The size of the board impacts on performance with oversight increasing as major shareholder positions are diluted with larger boards giving higher weight to the number of independent and non-executive directors (Eisenberg, 1998). Similarly,

Brown el al. (2011) comments the size of the board has been linked to disclosure quality.

Duality of the Chairman and CEO

A crucial controlling factor contained in the literature driving firm performance is the link between directors' pay and firm performance levels. This issue has been investigated in the literature, but mainly within the banking sector where salaries have risen well above the corporate average, and where the relationship between pay and performance is more controversial. According to Doucouliagos *et al*. (2007, p. 1363), when there is "a strong positive and direct association between CEO remuneration and prior year bank performance", the overall performance level is likely to be higher. The CEO is responsible for the implementation of measures of corporate governance within the organisation. The CEO is appointed by the board of directors and a high rate of CEO turnover is seen as a measure of instability and investment insecurity. This instability in the often perceived by the market as implying a conflict in direction and a continuing shift in governance and reporting transparency (Homstrom and Milgrom, 1994). The CEO often has a salary that is often linked to the financial performance of the business and this can affect the discretionary directions in reporting and accounting principles that are employed by the firm (Monks and Minow, 2001).

Auditors

One of the roles of both internal and external auditors of organisations is to ensure that there is an appropriate level of disclosure and governance. Therefore, the role of the auditor is to ensure that corporate governance measures are in place and are held accountable for the availability of transparent financial information which is asymmetrical and value adds to the firm through promoting investor confidence in the records (Bhagat and Black, 2002). There is a failing of internal auditors in developing countries with under-regulated markets as financial reports are manipulated to the benefit of political and particular major stakeholder interests (Rashid, 2008). The use internal auditors with differing accounting standards and weak corporate law without sound audit practice can lead to financial instability in these developing countries (Rashid, 2008). As the auditor is accountable to the Board of Directors who appoints them, there is little enthusiasm to contradict the desires in terms of final performance and disclosure in developing countries with limited governance regulations (Hanrahan *et al.,* 2001). External auditors improve governance through the perceived impartiality to approaching the records.

Audit Firm Size

The size of the audit firm has been used to determine disclosure quality in Saudi Arabia (Alsaeed, 2006). The use of a top five auditor can lead to improved confidence in the financial reporting of the organisation (Rashid, 2008). Good governance requires asymmetry in reporting and can indicate poor managerial performance and inefficiency (Dallas, 2004). There is often a manipulation in developing market of information which hampers investor confidence (Berghe, 2002). Transparency has been associated as a key to achieving effective disclosure in a number of studies and is herein used as the dependant variable in the assessment of disclosure quality (Riaha-Belkaoui, 2001; Shaw, 2002, Lang *et al.,* 2003).

Management Forecasts

Management forecasts provide forward-looking information which organisations can voluntarily provide in annual reports (Hassan and Marston, 2010). Hassan and Marston (2010) noted that the use of management forecasts in ascertaining the disclosure quality of an organisation was well established. The historical use of forecasts enables a gauging of disclosure quality to be taken because if items were not being disclosed in a timely way there would be an error in the realised results. The accuracy of forecasts therefore is a reflection of the disclosure of an organisation (Ng *et al.,* 2008).

Theoretical Perspective

The current theoretical literature on corporate governance is characterised by what Donaldson (2012, p. 256) refers to as "an epistemic fault line". This implies that there is a need for a more effective positive model of corporate governance that can better reflect the true dynamics of the modern global economy. In particular, the majority of research and theory development in the field to date has tended to focus more on the various individual components and aspects of corporate governance, rather than on the notion of corporate governance as an overall system. According to Choi (2011), a positivist approach to the analysis of corporate governance shows that many of the defining assumptions and systems of corporate governance are characterised by actions and roles of directors, managers and shareholders rather than on the organisational behaviour as a collective whole. Carver (2010) analyses the concept of global governance theory, which refers to the process of developing a global governance approach which has universal applicability. His study relies on the argument that the traditional model of the board governing the managers on behalf of the shareholders does not have a sound theoretical base and thus needs to be expanded and refined. This implies that the personal interests of members of the board may not be reflected in the actions that may not be in the best interest of all shareholders. However, both the work of Choi (2011) and Carver (2010) are fundamentally present concepts and claims without empirical justification. As such, there is a need for more work which can help address the lack of empirical research in the area, and look to create a model through analysis of the role of the overall corporate governance system in different national contexts.

In order to achieve this there is another theoretical barrier to be overcome, namely the lack of a unified and coherent framework for measuring and quantifying corporate governance in order to assess its impact on performance and disclosure outcomes. The lack of coherent framework is the consequence of inconsistent selection of variables across the studies into corporate governance. As a result of this, several authors have attempted to construct indices to examine the various aspects of corporate governance. For example, (Gompers *et al.*, 2003) constructed an index to measure the level of shareholder rights, using corporate governance measurements proposed by the Investor Responsibility Research Centre, the IRRC, including charter provisions, by-laws and other rules. This study was able to use this measure to demonstrate a link between shareholder rights and firm value and profitability. Bebchuk *et al.* (2009) constructed another measure, based on Gropers *et al.* (2003), focusing on the role of boards and super-majority requirements using the same requirements, again showing that shareholder protection helped to increase firm value, and using a more general approach to the analysis.

In a broader study, Brown and Caylor (2006) created their own corporate governance index through a combination of over 50 corporate governance provisions proposed by Institutional Shareholder Services, ISS. This study showed that firms with higher levels of governance experience higher levels of performance, in terms of returns on equity and return on assets. Finally, Pahuja (2011) provided empirical support for this approach in the developing economy context through the creation of his own proprietary, Corporate Governance Quality Index. This paper showed a positive relationship between governance practices, in the form of board effectiveness, and market valuation measured in terms of Tobin's Q (Pahuja, 2011).

Agency Theory

The dominant approach to corporate governance continues to be agency theory (Jensen and Meckling 1976). This theory was brought to prominence by the work of Fama (1980) and Fama and Jensen (1983) around thirty years ago, and has remained at the forefront of modern corporate governance literature for the majority of this time. The central premise of the agency theory framework is that the owners of the company, usually the shareholders are the principals and they appoint managers as their agents to ensure the smooth running of the company to allow them to make returns. However, the shareholders and managers tend to have different levels of

access to information within an organisation, as well as broadly divergent approaches and interests and risk preferences. Consequently, managers may in a manner that is not consistent with the interests of the shareholders, and may not provide optimum returns (Bathala and Rao, 1995). As a result of this, agency theory focuses on the necessary steps that need to be taken, and the systems that need to be implemented, in order to restrain managers and ensure they act in the interests of the shareholders (Agrawal and Knoeber, 1996).

Using agency theory based conceptual framework, Renders and Gaeremynck (2012) showed that the severity of the agency conflict in an organisation has a direct impact on the quality and effectiveness of corporate governance. Similarly, Jiraporn *et al.* (2012, p. 208) showed that the existence of weak corporate governance quality caused organisations to take on additional levels of leverage, as the leverage "substitutes for corporate governance in alleviating agency conflicts". The primary method of controlling for agency conflicts in the literature is largely to attempt to align the interests of the principals and their agents through remuneration and equity ownership. Recent empirical research by Nyberg *et al.* (2010) demonstrated that financial alignment between CEO and shareholder returns can help boost firm performance by mitigating agency conflicts, although the research does not make it clear by which mechanism this occurs. Indeed, according to Lan and Heracleous (2010) whilst agency theory is a strong predictor of corporate governance outcomes, it is not as effective at predicting the specific governance mechanisms, and should be reconsidered with the corporation as the principal rather than the shareholders. Whilst this argument is not fully supported in the literature, it does show that agency theory remains the significant means of explaining corporate governance analysis. However, this theoretical approach is not without issues that need to be resolved.

Stewardship Theory

Davis *et al.* (1997) described Stewardship theory by introducing the stewards, who are the managers and executives of an organization, are responsible for protecting and maximizing the wealth of shareholders by making use of appropriate performance within the organization to gain better results for the shareholders. This theory is quite different from agency theory, which stresses on individualism perspective. Instead, the senior management is required to perform as an organization's important part to help it achieve better results (Mallin, 2007). The main goal of stewards as per the theory is to make the organization achieve its goals.

The structure of an organization is given due importance by the Stewardship theory. The management is expected to perform in an autonomous manner to maximize the returns for its shareholders. The theory suggests that the management and CEO works towards achievement of the organization's goals without interfering each other and this helps in avoiding any losses for the shareholders (Davis et al., 1997). Instead, the shareholders are likely to gain positive returns through the efforts put forward by the stewards. This theory is quite prevalent to the organizational systems of Japan where employees are given complete job ownership and the flexible environment helps in attaining better performance of the stewards as per organizations' objectives.

Thus, the theory here assumes that the stewards (i.e. the management) works as per the desired objectives of their organization and their personal goals are in line with organizations' objectives (Clarke, 2004). This reduces the chances of any conflict taking place within the organization as all the management, CEO and shareholders have a common objective of improving the performance of their organization for maximum results through limited set of resources available to them.

Methodology

Quantitative Method

The study will focus on listed companies on both countries. The sample itself will be comprised of 100 Saudi Arabian and 100 Australian listed companies covering all sectors except the financial sectors as the literature indicates that governance relationships in these sectors can be variable, based the market capitalisation with the largest firms selected (Doucouliagos *et al.,* 2007). We will choose 100 non-financial companies from Saudi listed companies out of 150 and the data will be collected for Saudi financial Market *(Tadawul)*. Regarding Australia we will collect our data form Australia Security Exchange (ASX) for top 100 companies.

This study will examine records for a period of five years, from 2008 until 2012. Australia as a developed countries and Saudi Arabia as developing countries, both of them did not affected by last financial crisis. So it is important to study this time of period. First task; we will collect data of Australian companies then Saudi companies after finishing from Australian.

The SPSS statistic software will be used to analyse our data.

The use of multiple regression to test relationships between corporate governance and finical performance (Cheung *et al*., 2010; Sami *et al*., 2011; Gompers *et al.,* 2003; Core *et al.,* 2006; Bauer *et al.,* 2004; Vander Bauwhede, 2009; Doucouliagos *et al.,* 2007; Talha *et al.,* 2009), as well as the relationship between disclosure quality and corporate governance (Eng and Mak, 2003; Quick and Weimann, 2011; Peterson and Plenborg, 2006; Rogers, 2008; Karamanou and Vafeas, 2005; Nelson *et al.,* 2010; Hutton, 2007; Laidroo, 2009).

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