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Research Article

Effect Of Family Ownership On Audit Committee Activity: An Analysis Based On Saudi Firms

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ABSTRACT

This study investigates empirically the relationship between one of the major corporate governance attributes (family ownership) and the audit committee activity across a sample of 430 publicly traded firms in Saudi Stock Exchange for the period 2012-2019. Using the Pooled OLS regression, this study finds that family ownership is negatively associated with audit committee activity. This study provides insightful evidence to policy makers on the relationship of family ownership and audit committee activity.

Keywords: Audit committee activity; Family ownership; Stock exchange

INTRODUCTION

The objective of this paper is to examine the association between the family ownership and audit committee activity. An audit committee is always considered one of the corporate governance accomplishments considering the important role in ensuring transparency in financial reporting. It acts as a subsection of management in corporate governance and responsible for administering a company's financial reporting process. The audit committee is also critical in enhancing risk management, external reporting, and internal control procedures of organizations. Similarly, an audit committee acts as an important communication channel facilitating communication between internal auditors, external auditors, and the board cites that an active audit committee plays a vital role in sending a positive signal about the quality of an organization's accounting and financial information, especially when agency costs are high. Other findings allude that an effective audit committee ensures accuracy in financial reporting, functional risk management, and effective internal control for individual companies. Additionally, an active audit committee improves transparency in security markets, which is essential in bettering the protection of shareholders' interests and enhancing an organization's book value. Recent findings show that the frequency of the auditing committee meetings is primarily implemented as a proxy for audit committee proficiency and to observe certain benefits of an organization's financial reporting with a well-established audit committee [1].

The connection between the audit committee and the family ownership can be illustrated by using the convergence-of-interest theory, which indicates that the agency decreases costs as the owner manager's ownership interest goes up. External investors sometimes consider the owner-manager's behavior as a way of maximizing company value when the owner manager's holding is huge. Under such circumstances, there is an occurrence of convergence-of-interest between outside investors and the owner-manager. Findings reveal that most firms based in Arab still practice concentrated ownership. As such, family involvement and generational ties often impact governance relations as well as agreements, and they form an integral part of economic and political influence. Ownership structure in various Saudi organizations is infiltrated with the dominance of one primary owner. The dominant owner, who is often the founder or an immediate family member, has a huge share (family ownership). However, less than the majority of the company's holdings, the family ownership is large enough to be the largest shareholder but often less than most of its holdings. The dominant owner is always in the center of the company management. They actively participate in important decision-making procedures directly or indirectly, thereby influencing most of the management decisions (INSEAD, The Business School for the World, 2010). Family control and ownership are common in GCC companies. Due to their success, family firms are considered the backbone of the Gulf region's economy, accounting for about 80 percent of the non-oil GDP.

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Empirically, the relationship between the audit committee and family ownership was extensively explored. For example, examined the association between the audit committee's existence and the family ownership. The outcome showed a negative relationship for family ownership between 5 and 25 percent with an audit committee's existence. Conversely, the positive for family ownership is greater than 25 percent. It conclude higher levels of family shareholdings can have two conflicting effects on an organization's performance. It also explored the association's effectiveness between audit committees with family ownership. The outcome indicates a positive association. On the other hand, allude that there is a negative association between controlled families' presence on the quality of audit and the board of directors. They conclude that the participation of a royal family member on the board of directors translates to a greater impact on internal monitoring. Subsequently, it replaces the need for external monitoring demand for higher audit quality in Saudi, thereby reduces auditing costs. Similarly, examination shows a negative association between audit committee meetings and board meetings frequency. The current research studies focus on the developed and developing markets. Moreover, the findings reveal that there is limited evidence from the GCC countries. Also, a number of previous findings have either conflicting results or are documented inconclusively; hence the need to conduct a more empirical investigation regarding the audit committee's activities. As such, this study aims to expound on the results of the current research studies on the audit committee meeting frequency by adding new pragmatic evidence to the literature of corporate governance using the current data [2].

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.

MATERIALS AND METHODS

This study is based on manufactured Saudi firms listed on Saudi Stock Exchange for the periods ranging from 2012 to 2019. This is the most recent period for which data were available at the time of the study. Our final sample comprises of 430 firm-year observations. The number of the audit committee meetings, board size, board meetings, total assets, debts, performance, and age were hand-collected from annual reports available on the web site of the Saudi Stock Exchange. Samples selected depicted in (Table 1) [3].

Sample Selection	Total Observations
Total observations	465
Observations discarded (outliers, missing and incomplete data)	(35)
Final sample	430

Table 1: Sample Selection

We control for several variables that are evidenced by prior studies to have associations with audit committee meeting activity as a monitoring mechanism, varying based on the level of the agency costs. As for the association of board size and audit committee activity, reported a positive relationship between board size an audit committee meeting frequency. Regarding the association of board meeting with audit committee activity, reported a positive association relationship between board meetings and audit committee frequency [4].

Research studies show that there is a likelihood of companies with poor performance to experience financial fraud and errors, necessitating the need for effective internal auditing. Other studies consider profitability as a control variable impacting the audit committee meeting frequency. Regarding the association between a company's age and the audit committee meeting frequency, It postulates that an organization's age is considered an important factor in its stability and growth in the contemporary business world. Adds that an organization's age has been largely utilized as a proxy for its experience over a long period in the economic world, which positively impacts its performance. Corporate management has been acquiring significant information regarding skills and capability over the past years [5].

Regression model and definition of variables

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.

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

Variables	Acronym	Operationalization	Type of variable
Dependent Variable			
Audit committee activity	ACACTIV	Number of meetings held during the year	d.v
Hypothesized variable			

Family ownership	FOWN	Percentage of common shares held by founding family and their relatives	i.v
Control variables			
Board size	BDSIZE	Number of directors on the board	i.v
Board meeting	BDMEET	Number of meetings held during the year	i.v
Firm performance	ROA	Return on assets	i.v
Firm age	AGE	Number of years since the company is established	i.v
Note: d.v – dependent variable, i.v – independent variable			

Table 2: Summary of the Operationalization of the Research Variables

RESULTS AND DISCUSSIONS

Statistics and correlation

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

It displays that there is a significant range of variation among the considered sample of this study. It is shown that the range of FOWN ranges from.00 to.73 with a mean of.0548 and a standard deviation of.11073. ACACTIV is from 2 to 12 with an average of 5 and a standard deviation of 1.53456. The ranges of BDSIZE is from 4 to 11 with an average 8 and a standard deviation 1.50127. The mean of BDMEET is 5 and it ranges from 2 to 22 and a standard deviation of 2.11237. The ROA ranges from 0.00 to 1.00 with an average of.5071 and a standard deviation of.31905. As for the AGE, the mean is 28 years and it ranges from 2 to 64 and a standard deviation of 14.61850 [6].

It 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.235.

Regression results

It depicts the estimated regression coefficients for the regression model, the variance inflation factor (VIF), and the tolerance results. The highest VIF score obtained is 1.145 and the highest Tolerance score obtained is 0.936. This confirms the non-existence of multicollinearity problem in which the VIF is lower than the threshold of 10 and Tolerance is lower than the threshold [7].

It report the adjusted R2 and the F-value for the audit committee activity model. The F-value for the model is statistically significant at the 1% level, indicating that the overall model can be interpreted. The adjusted R2 is 0.215, indicating that the model has explained 21.50% of the variance in the audit committee activity. This indicates a good fit of the audit committee activity model [8].

The regression results in Tables 5 show that the sign of the coefficient of the FOWN is in the predicted direction (i.e., negative), giving support for the hypothesis expecting the higher the percentage of family ownership, the lower the frequency of audit committee meetings. This gives support to the convergence-of-interest hypothesis and it is consistent with that reported a negative association between the presence of controlled families on the board of directors and audit quality. They indicated that the existence of royal family members on the board of directors means more powerful impact in terms of internal monitoring and, consequently, it substitutes the external monitoring demand for higher audit quality in Saudi context. In the same line, reported a negative association between board meetings and audit committee meeting frequency. Therefore, the existence of family ownership as a monitoring corporate governance mechanism substitutes the audit committee activity as another monitoring mechanism [9].

This study investigated the association of family ownership with audit committee activity among 430 manufactured Saudi listed companies for the period 2012-2019. This study reported that family ownership is negatively associated with audit committee activity, giving support to the convergence-of-interest hypothesis and it is consistent with the findings. Therefore, the existence of family ownership as a monitoring corporate governance mechanism substitutes the audit committee activity as another monitoring mechanism. This study contributes to the extant literature in corporate governance. It provides empirical evidence on the associations of two internal corporate governance mechanisms, namely; family ownership and audit committee activity in the Saudi context where there is a paucity of research in this area. Therefore, this study provides an additional empirical evidence to the literature body of corporate governance [10].

CONCLUSIONS

The findings of this study might have practical implications for the Saudi stock market that provide a new understanding regarding the extent to which family ownership impacts the activity of audit committees in manufacturing companies in a manner to practice their monitoring responsibility and to protect the interests of shareholders. Similarly, the companies' management, external auditors, bankers, and companies would also benefit from understanding the influential factors of the audit committee activities. Although this study has recognized its objectives, it still subject to several limitations. For example, the sample of the study largely focuses on manufacturing firms. This brings the need for future research to consider incorporating other sectors such as merchandising, service, and telecommunication. Similarly, the study considers the family ownership as a hypothesized variable and audit committee activity as a dependent variable. Future studies could involve other determinants such as audit committee effectiveness score and other ownership classifications such as governmental ownership and institutional ownership. Additionally, this study was conducted in Saudi settings. Future research could replicate a similar model in different GCC countries and other Middle East countries.

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