

Does Royal Directors Matter for Decreasing Earnings Management in GCC Countries?

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Abstract: This study examines the effect of royal board members on earnings management. The sample data on nonfinancial listed companies in Gulf Cooperation Council countries (GCC) are hand-collected from Capital IQ and annual reports. The sample data cover the period from 2010 to 2013. We conduct an OLS test on six countries as one aggregate population and individually. The results are mixed. We find no relation between royal family directors and earnings management in Bahrain, Oman, Qatar, and the United Arab Emirates. However, a statistically significant and positive relation exists between royal family directors and earnings management in the Saudi Arabia. But, a statistically significant and negative relation exists between royal family directors and earnings management in Kuwait.

Keywords: Corporate governance; Royal family directors; Earnings management; GCC countries.

JEL Classification: G34, G38, M48

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1. INTRODUCTION:

Recently, corporate governance (CG) has become one of the most important concepts for publicly listed companies. This is particularly the situation since the recent financial crisis in 2008 and the collapse of international companies due to largely to earnings management, which weakened the economy of world countries (Tricker, 2009). Thus, earnings management has captured considerable attention from both academic and politicians in the past two decades.

In general Earnings management “occurs when managers use judgment in financial reporting and in structuring transactions to alter financial reports to either mislead some stakeholders about the underlying economic performance of the company or to influence contractual outcomes that depend on reported accounting numbers.” (Healy and Wahlen, 1999). According to Burgstahler and Dichev (1997) argue that the manager may engage in earnings management to show profits or specific value reflecting the firm’s performance in order to meet the analysts’ predictions. They also claim that the manager can manipulate earnings to avoid earnings decrease and losses. Beside that the literature reports that the political connection is a double –edged sword in governance and managing earnings of the company (Khwaja & Mian, 2005). Corporate governance literature has overlooked the relationship between royal family members on the board and earnings management which in turn impact the governance of the firm.

Thus, the motivation of conducting this study as follows: There have been several calls for more academic research in

the field of corporate governance, earnings management and uniqueness of institutional setting (Algamdi, 2012; Al-Junadi et al., 2016) in emerging countries. Added to that Political connection has great influence on the whole economy of the country and the economic life of individual firms and influence corporate governance (e.g. Fisman, 2001; Khwaja & Mian, 2005; Sun & Tong, 2003). Royal family members are considered a political-connected member at the board. Therefore, the prevalent research has not yet researched in depth the effect of royal family members on the board on earnings management (Al Nasser, 2018 & 2019). Furthermore, the few existing studies are not reaching agreement in the results. The possible reasons for this mixed evidence (Al Nasser, 2018 and Alghamdi, 2012). First, using different institutional setting and analysis of the data. To that end, it is crucial to explore the royal family members on the board if they prevent or encourage earnings management in the GCC countries.

The GCC was founded in 1981 and consists of six Arab states, namely Bahrain, Kuwait, Oman, Qatar, Saudi Arabia (SA), and the United Arab Emirates (UAE), all of which are Gulf Monarchies. Research into CG became active following this period (Alagha, 2016). GCC countries provides a unique and rich institutional setting to examine the research question which is how the royal family members on the board monitoring the executive to mitigate the earnings management and play resource providing role which is differ from other board of directors members.

Literature typically focuses on of politically connected board members and treat all firms homogeneously. However, in GCC countries as Gulf monarchy the royal family members involve and influence the economy of the country and the economic life of individual firms. On one hand, political

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connected board members may not act in the best interest of outside shareholders. On the other hand, royal family members are different than politically connected board members, thus they have different interest and incentives. Therefore, GCC countries provide a rich setting that enable us to study the effect of royal family members in different scenarios (Baydoun et al., 2013).

GCC countries provides the largest market for studying the consequence of royal family members on the board. At the same time, GCC countries is rich, the largest exporter of oil and growing emerging market. As such, it is important to obtain an insightful understanding of royal family members on the board on earnings management in GCC countries (Amico, 2012).

Reviewing empirical studies pertaining to CG and earnings management highlighted a notable gap in the literature as most concentrate on USA and Europe (Bekiris and Doukakis, 2011; Ebaid, 2005). Thus, there is a dearth of literature on GCC countries as emerging markets, and it is important to understand this part of the world. Thus, the primary objective of this study is to investigate the ability of royal directors on decreasing earnings management in GCC countries.

This study regress the earnings management attribute on royal family directors, CG and control variables. The study used Tobit regression in STATA software to analysis GCC countries as one population. The reason of analysing the GCC countries as one population is because they have a lot of features on common. The main results of the analysis are that there is a negative relationship observed between royal family directors in GCC and earnings management. Also, after changed the analysis type and the Royal director measurement, still the result same as the fundamental measurement, supported by leadership and resource dependence theories. Our results shows that royal family members on the board can mitigate the earnings management and play role of providing a resource to the firm. We are confidence to conclude that our evidence would influence investors perspectives when the royal family member present on the board of directors.

The current study contributes to the literature in several ways: while most of the previous studies investigate the effect of independent or executive on earnings management (Ocasio, 1997), we investigate the effect of royal family members on the board on firm earnings management. Specifically, we examine the research question using two different theories leadership theory and resource dependence theory rather than focus on agency theory which is the dominate theory in corporate governance and earnings management studies or research. A deep understanding of the royal family members' effect on earnings management provides important implications for the corporate governance system especially for a firm with a royal family members serving on the board. In addition, studying GCC countries data enables a better assessment of generalizability of pervious conclusions regarding the relationship between royal family members and earnings management (Al Nasser, 2019, Al -Hadi et al., 2017).

We contribute to the literature on political connections; the literature typically investigates the consequence of politically

connected manager and politically connected board member. We instead focus on royal family whose incentive can capabilities may differ substantially from those of politically connected manager or board members. This focus has not been widely documented in the previous research (Al-Hadi et al., 2017). More interestingly, we deepen the understanding of the possible role of royal family members on the board by showing that they provide a good monitoring by mitigate or prevent earnings management. Extending (Al-Hadi et al., 2017) arguments about the role of royal family on the board in influencing the corporate governance and earnings management. Our study reminds managers and controlling shareholders and outside investors of the potential positive effect of royal family members on the board. Overall, our result provides a new perspective with regards to the royal family on the board and their significant implication for investors and policymakers.

Finally, including this variable will fill an important gap in existing literature due to considering the environment's setting where ownership concentration is prevalent and where the presence of politically connected directors on a board is the natural form of political connection (Al Nasser, 2019).

The remainder of this study is organised as follows: section (2) discusses the Theoretical framework and Literature review. Section (3) provides the Hypothesis development. Section (4) describes the methodology. Section (5) analyses and discusses the results. Section (6) concludes the study.

Institutional Background of GCC Countries

A brief background of GCC countries is needed to have some understanding of the institutional setting. In this section, some light is shed on GCC countries in general, and brief information about each country is provided. The Gulf Cooperation Council (GCC) countries, was founded in 1981 and consists of six Arab states namely Bahrain, Kuwait, Oman, Qatar, Saudi Arabia (SA), and the United Arab Emirates (UAE), all of which are Gulf Monarchies (Amico, 2012). GCC countries are located in the Middle East. Specifically, Arabian Peninsula and their total population are 50.1 million people (Amico, 2012). They also share similar Arabian culture and traditions, the faith of Islam, social structures, wealth, political development (Monarchy), and demography (Baydoun et al., 2013). The primary purpose of the establishment of GCC was to enhance the cooperation and integration as well as to strengthen their economy and development through their participation in different fields such as the economy, financial affairs, education, cultural activities, social, medical, agricultural development, research development and joint projects. Between them, they can issue similar policies and regulation to achieve unity (Amico, 2012). It is also worth mentioning that each country has an independent government and their own independent currencies (Al-Hadi et al., 2017).

There are differences between GCC countries as developing countries and developed countries. Unlike developed countries, GCC countries suffer from the inadequate protection of investor's rights, insufficient legal systems, weak and illiquid stock markets and, government intervention. There is also the problem of the lack of quality information, economic uncertainty (Reed, 2002; Ahunwan, 2002; Tsamenyi et al.,

2007; Young et al., 2008), and government of listed and unlisted companies and different sized companies (large, medium, and small companies) (OECD, 2005; Tricker, 2009) and non-transparent communication. Equity markets in the region less established as those in developed countries. These also characteristics of countries follow the civil law legal system. Families dominate the board of directors (Arouri et al., 2014; Rabelo & Vasconcelos, 2002). For instance, when firms are under family ownership, the controlling family, specifically the head of the family intervene into overseeing the management, decision-making, selection of management (OECD, 2005; Tricker, 2009). Due to family ownership of the firms, controlling family prefer debt financing over equity financing to maintain their ownership and control of the firm.

There also differences between GCC countries and other emerging markets are as follows: GCC stock markets typically have a smaller number of listed firms, lower diversification, and have lower connections with international markets (Yu & Hasan, 2008). They are also “overly sensitive to regional political events” (Held & Ulrichsen, 2013). They also have modest competition for listings companies, small markets, high levels of retail investment, diversification of financial products and low free floats (Amico, 2012). The state-owned stock markets regulate, monitor and enforce CG code in listed companies (OECD, 2012). On average, GCC companies have few independent directors on the board comparing to other countries. According to the Union of Arab Banks (2003), investigations of the CG practice in public listed companies in Kuwait, SA, and the UAE, besides other countries, namely Lebanon and Jordan; find that there are few truly independent directors on boards. Also, firms are more likely to follow CG code symbolically in the selection of independent directors and to copy CG style in the western countries (Ferrarini & Filopelli, 2014). These countries are major suppliers and players of energy markets and are planning to have a common currency (Al-Ajmi, 2009). They have a high number of foreign workers; with 90 percent, 70 percent, 50 percent and 30 percent expats in UAE, Qatar, Kuwait, Bahrain, Oman and Saudi Arabia respectively (Held & Ulrichsen, 2013). The participation of institutional investors is low compared to other developing countries such as China and other developed countries such as the US, UK, and France (Kiel & Nicholson 2003). This increases the volatility of the market because retail investors are more inclined to withdraw capital quicker and the price quality is weak (Amico, 2012). However, institutional investors are not always right participants as some focus more on short-term investment objectives and do not have the ability and interest to promote CG. In addition, institutional investors are less developed in the region and do not disclose their voting results to the public or regulators, as they do not have a clear policy regarding this issue (Held & Ulrichsen, 2013).

2. THEORETICAL FRAMEWORK AND LITERATURE REVIEW

The research considers the effect of the presence of royal family members on the board, which is a unique aspect in the context of the GCC countries.

2.1. Theoretical Framework

Different theories exist to describe a board of directors, and some of them contradict each other, but the aim of all of these theories is to explain the effectiveness of the board of directors in firm outcomes (Certo, 2003). Furthermore, in the literature, the board of directors has been investigated based on two perspectives, their function internally and externally on the firm (La Porta et al., 1998). This study aims to focus on a core issue which is the effect of royal family member on earnings management. Thus, how a royal family board membership may deal with leadership and resources in term of governance issue such as managing the earnings. Thus, the theoretical framework of the study is based on leadership theory and resource dependence theory. The motive of using these theories is that the royal members on most GCC companies as we mentioned earlier are also shareholders. So, implementing the agency theory, which is the most recognizable theory in corporate governance study, on the royal family of board members is not appropriate. This study adopt leadership theory and resource dependence theory to support the objective of the study.

Leadership Theory

There are many definitions of leadership based on the concept the author attempts to define (Stogdill, 1974). For purpose of the study, this study adopts Bass' definition (1985) which is “leadership that inspires employees to go beyond their self-interest and instead focuses on the norms, value and goals of the organization to subsequently perform beyond expectation” (de Koster et al., 2011). It is not surprising that there is such weighty consideration applied to the topic of leadership given the high expectations and demands placed on those at the most senior levels. Leaders of organisations are expected to understand the complexity of the world in which they operate have the “intelligence, sensitivity and ability to empathise with others” (Tseng, Tung and Duan, 2010) while also ensuring their businesses are run profitably, safely and meet the needs of all stakeholders especially the interest of shareholders.

Effective leadership by managers and supervisors within an organisation is recognised as playing a crucial role in the development of an organisation's corporate governance culture (AlNasser, 2018). Surprisingly, the leadership theory is often not considered in the literature when exploring the effect of corporate governance on earnings management. Therefore, this research study will focus on the interaction of three concepts: leadership theory, corporate governance and earnings management when we examine the royal family member on the board.

According to the literature the elite or political connected board leader in an organisation have the highest influence on board of directors behaviour. Elite or political connected leader is more likely to be familiar with policies and have goals and priorities that influence directly and indirectly the dynamic of board of directors with regard to corporate governance and earnings management. In order to be effective leader, leaders need to continuously demonstrate a visible commitment to corporate governance code. Further, the

behaviour of leader will reflect the priority they place on corporate governance. So, the rest of board members and management can interpret these behaviours to create ideas and norms as signaling the importance of corporate governance in terms of minimizing the earning management and maximizing the interest of shareholders to their leaders.

Boards are the ultimate decision makers in an organisation and while they do not have operational responsibilities, directors do have specific individual responsibilities to the company in deciding how the company is governed. A board of directors is responsible amongst many other duties for safeguarding the interests of shareholders, monitoring management and approving corporate strategy (Nicholson and Newton, 2010). In this way, board are ultimately responsible for determining those issues that are of most importance for the organisation and in turn determining what issues the CEO and senior executives focus their attention upon (Ocasio, 1997). These areas of focus are frequently communicated in the case of a publically listed company, via annual report and therefore the use of these written communications will be an important area for investigation as they relate to disclosures of safety-related activities. Leadership of senior manager is of paramount importance in improving the performance. leadership is viewed as having a natural connection with the qualities needed to enhance firm corporate governance. In addition, leadership theory is seen as control based compliance with corporate governance practice.

The term leaders has been used ambiguously in the literature and it is often unclear which level of leadership is being assessed (Flin and Yule, 2004). Roger et al., (2010) sought to define senior leaders as the individuals who lead the organisation and work at a strategic level, acting as chief executives directors and general managers. For clarification, an organization may have a range of leadership levels, therefore researchers must first decide which level of leadership he/she is assessing (petersen, 2005; Wu, 2008), particularly given there are significant differences between management level within an organisation and their impact on corporate governance (Rofer et al., 2010). Senior leaders are including board members and senior executives. On the other words, individual in formal leadership roles such as board members and senior executives have a particularly strong potential to influence the corporate governance adoption and management behaviours regarding earnings management through emphasizing of transparency and faithful representation of company financial reporting. Thus, leadership theory will be pivotal throughout this study and will focus primarily on leadership theory (Bass, 1990).

This study will explore corporate governance and earnings management using the role of leadership of a royal family members on the board of directors. There have been few studies investigating the leadership influence of senior leader on corporate governance and earnings management. Leader may offer a number of incentives and or punishments that contingent on the subordinate's performance meeting agreed standards known as contingent reward (Bass & Avolio, 1994). Leader use their transactional leadership to gain compliance from followers, set goals, agree on what needs to be accomplished monitor performance and administer reinforcement accordingly (Flin & Yule, 2004).

Resource Dependence Theory

With respect to the resource dependence theory, management scholars determine the number of important resources that a firm has such as business elite with access to information and capital who have the expertise to link with competitors as well as the firm's legitimacy, suppliers, customers, and stakeholders, all of which add value and maximise its performance. These studies argue that the higher the ability of the board of directors to connect to the external environment, the higher the degree of access to various resources, which in turn leads to better performance for the firm. Pfeffer and Salancik (1978) claim that the diversity of a board of directors is essential for a firm to access future capital or manage its contingency. There is a resource gap between firms in emerging markets and those in developed markets because emerging market countries suffer from low availability of capital, high costs, poorly developed financial markets, and volatility in economic development (Hitt et al., 2000). Thus, the firm should establish ways to link to the external environment through its board of directors. Specifically, not all board members have similar power, prestige, and reputation, which means it is likely that they will differ in how they can assist the firm. The prestige of a board of directors can include their skills, experiences, and social connections (Certo, 2003). A number of studies have discussed the importance of attracting board members with power and prestige in the community. Certo (2003) argues that some firms prefer to appoint members to the board of directors who are powerful, well-known, and involved in the community in order to help the firm access resources. Certo (2003) asserts that when prestigious directors serve on the board, the credibility and performance of the firm improves. In addition, Bazerman and Schoorman (1983) note that the reputation of the firm also depends on the influence of an individual serving on the board and the individual's connections and networking capacity. Thus, establishing the reputation of board members is important because potential investors may have little data to assess the quality of the firm's management and its performance (Certo, 2003). This theory also views the board as a provider of resources, such as linking the organisation to external environments, which leads to better performance. The resource dependence theory assumes the enhancement of firm performance through the involvement of independent directors in terms of decision-making, networking, and their ability to link firms to the external environment (Pfeffer & Salancik, 1978).

Hillman and Dalziel (2003) suggest combining agency theory and the resource dependence theory. Furthermore, Dalton et al., (1999) emphasise the importance of studying corporate governance using a multi-theoretical approach to understand the effect of corporate governance mechanisms and structures. Utilising different theories can overcome each theory's limitations and can help in concentrating more on the internal structures. Thus, considering different theories or integrating them help to gain a greater understanding. It also helps to clarify the effect of corporate governance on earnings management (Deegan & Unerman, 2011). To address the research question and to test the hypotheses, this study considers the agency and resource dependence theories as the most relevant.

2.2. Literature Review

The research considers the effect of the presence of royal family members on the board, which is a unique aspect in the context of the GCC countries.

Royal Family Members on the Board of directors:

Since there is a dearth of literature of royal family and their impact on earnings management. Political connection literature is considered the best fit to build our case of the effect of royal family on earnings management. Political connection has great influence on the whole economy of the country and the economic life of individual firms (e.g. Fisman, 2001; Khwaja & Mian, 2005; Sun & Tong, 2003; Faccio et al., 2006; Charumilind et al., 2006; Fan et al., 2007; Claessens et al., 2008; Cheung et al., 2011). A set group of studies examines politically connected firms in an international context (Faccio, 2004 & 2006; Boubakri et al., 2008) while others investigate this variable in the US market (Kang & Zhang, 2012) and Canada (Morck & Yeung, 2004). In addition, a number of other studies use this variable as part of their studies (Goldman et al., 2009). The effect of politically connected firms is more significant and pronounced in the emerging markets where the legal system is weak, and the protection of shareholders' rights is poor. Therefore, most of the studies on connected firms are based in China, other Asian countries and Latin American economies (Fisman, 2001, Faccio & Lang, 2002; Wiwattanakantang et al., 2006).

Scholars also argue that political connection has a double-edged sword as it can enhance or jeopardize the firm EM. In other words, Faccio (2006 & 2010), and Chen et al., (2011) argue that the cost and benefit of a political connection to firms are different across countries and depend on the institutional environments. They note that politically connected firms are common in countries with high corruption and where the legal system is poor and lacks independence (Boubakri et al., 2008) compared to the countries with a strict legal system and strong protection of investor's rights. Added to that, there is evidence that shareholders are less likely to react negatively or to sue politically connected firms compared to their counterparts. The politician might help the company to get much-needed resources, but they want payback through "social policy goals."

The firms tend to appoint political members to access more benefits such as their knowledge, and expertise in government procedures and connections with government to get an advantage over their competitors (Agrawal & Knoeber, 1996) or to signal strong CG (Ang et al., 2016). Political connected firms may not be corrupted; thus they can influence positively the governance structure of the firm by aligning the interest of shareholders (controlling and minority) with government policies, which in turn, increase the investor's confidence and enhances firm value. Ahmed & Uddin (2018) argue that there are some key structural conditions, such as political connection and social relationships, which shape social interactions and CG practices. All of this can be related to the political environment and culture of the country and willingness of political people to abuse their powers or to not engage the management with political rent extraction (Ang et al., 2016). Ang & Ding (2006) find that politically connected firms in Singapore have strong CG and

higher firm valuation. Politically connected firms are provided with valuable resources such as obtaining cheap loans and other economic advantages, such as new and attractive business opportunities and links with rapidly-growing firms (Fisman, 2001, Faccio, 2002; Wiwattanakantang et al., 2006). Rajan & Zingales (1995) claim that in China, personal connections are important and beneficial for quick transactions compared to the usual long process of negotiation in the market. Maaloul et al. (2018) examined the effect of firms' political connections on their financial and stock performance and on their market value. Prior studies document that politically connected firms can have protection from some regulations such as preferential access to financing, reduced licensing fees, new state contracts and market entry barriers (Faccio, 2006). Johnson and Mitton (2003) and Khwaja and Mian (2005) examine politically connected firms in Malaysia and Pakistan, respectively and find that these firms are more likely to have easier access to debt financing than non-politically connected firms. Al Nasser (2018 & 2019) finds a negative association between royal family member on the board of directors in Saudi Arabia and earnings management.

Faccio et al., (2006) provide evidence that it is easier for politically connected firms to receive government bailouts even if, before and after the bailout, the firms are underperforming. Goldman et al., (2009) find that government officials can impact the direction (allocation) of profitable contracts with the government to their connected firms which may then open up more opportunities to go abroad if the government officials have outside connections. Goldman et al., (2009) also document that the large impact of politically connected firms on value comes from the belief of the market that political connections do provide benefit to the firms. Algamdi (2012) finds a positive relationship between the presence of the royal family member on the board of directors and earnings management. AL-Hadi et al., (2016) examine the relationship between the presence of royal family members on the board and the quality of risk reporting. The result of the study is that the royal family members on the board of directors reduce the quality and extent of risk disclosure. Al-Hadi et al., (2017) find a positive and significant relationship between the level of transparency and the royal family on the board of directors. Firms with the royal family on the board have better corporate governance in terms of reducing market risk and increase disclosure. Finally, a number of studies find no association between politically connected board members and earnings management (Wiwattanakantang et al., 2006).

Female on the Board

The development of corporate governance around the world encourages diversity on the board of directors (Terjesen et al., 2009). Firms face more pressure to engage and point out females on the board of directors to minimise the gender gap and diversify the boards (Smith et al., 2006). However, the presentation of females on the board differs between developed and developing countries. Additionally, scholars have highlighted the effectiveness of female directors as a device since they have different backgrounds, views and problem-solving abilities (Anderson et al., 2011). All of these would lead to better financial performance (Pfeffer &

Salancik, 1978; Terjesen et al., 2009; Adams & Ferreira, 2009; Ferreira, 2010; Anderson et al., 2011; Anderson et al., 2011). Abdullah et al., (2013) claim that female directors have the ability to influence the environment of corporate governance, the function of board and a firm's earnings quality. The presence of female board members is especially important in environments where the protection of shareholders is poor (Bianco et al., 2015). However, A number of studies claim that the involvement of female directors has a negative effect on earnings quality (Smith et al., 2006; Adams and Ferreira, 2009) due to a lack of qualifications and skills needed for directorship. Thus, few women sit on boards and those that do are monitored closely. This leads to an increase in costs for the agency and a reduction in firm performance and value (Cashman et al., 2012; Falato et al., 2014; Field et al., 2014).

Independent Directors

Appointing independent directors is considered one of the internal corporate governance mechanisms to reduce agency cost and information asymmetry problems in the Modern Corporation (Fama, 1980; Lipton & Lorsch, 1992; Jensen, 1993). However, there are two streams of the theoretical view of independent directors on the board: those who support more independent directors and those who are in favour of more executives on the board.

The first group claims that an independent director can be more accountable than an executive (Fama, 1980; Sonnenfeld, 2002) due to their independent judgement of board decisions (Cadbury report, 1992; Chhaochharia & Grinstein, 2009). Independent directors are not supposed to be dependent on a firm financially and in accordance with best practice of corporate governance and corporate governance in GCC countries, they should not have close family ties to the company. They should not receive fees, which are not related to the performance of the company, nor serve on the board for more than nine years. They should not hold cross-directorship in other companies, and they should not address specific groups of shareholders. If these characteristics are met, independent directors are thought to be in a position to monitor management more effectively and refuse any pressure to accept earnings manipulation. In addition, they can add to firm resources in terms of experience, expertise, business contacts and reputation (Haniffa & Hudaib, 2006; Baranchuk & Dybvig, 2009). Due to the fact that senior management could dominate the board of director's decision to expropriate shareholders' wealth, independent directors can offer an effective monitoring function of the board's decision-making process (Fama, 1980; Fama & Jensen, 1983). For instance, Brickley et al. (1994), Byrd & Hickman (1992) and Weisbach (1988) find that firms with more effective board monitoring have more independent directors.

The opponents of more independent directors on the board argue that they have less knowledge about the company, (Weir & Laing, 2000) potentially resulting in lower quality decision-making (Haniffa & Hudaib, 2006). These are part-timers who are normally present on other companies' boards (Bozec, 2005; Jiraporn et al., 2009). Therefore, they have little time to understand the complexities of the company and offer effective monitoring which negatively

influences firm performance (Baysinger & Hoskisson, 1990; Weir & Laing, 2000; Bozec, 2005). Kiel & Nicholson (2003) claim that a greater number of executives on the board could provide better decision-making leading to better financial performance due to a higher level of knowledge about the company. In addition, according to Baum, (2016) claims that empirical evidence of the effect of independent directors is still unclear as global financial crisis added doubt of their effect. Thus, a high number of independent directors on the board is not always good.

3. HYPOTHESIS DEVELOPMENT:

3.1. Royal Family Members

As mentioned earlier, the economic environment of the GCC region has a weak legal system, poor enforcement and protection of shareholders' rights. Based on the earlier argument and discussion, royal family members have relatively stronger powers. It is not necessarily that the royal family member on the board behaves opportunistically to achieve personal benefit at the expense of other shareholders, especially a minority one (Al-Hadi et al., 2016). Other scholars also confirm the benefit of having royal family members on the board as they can stop the intervention of government that hinder the expansion of the firm domestically and internationally (Hertog, 2012). Many members of the royal family are appointed as non-executive directors on the board of directors (Alghamdi, 2012). Therefore, they always seek to protect themselves from any unfavourable outcomes, which may influence their status (Henry & Springborg, 2010). Thus, they have an incentive to monitor management effectively and discourage earnings management, leading to higher EQ (Batta et al., 2014). In other words, as ruling family members have the political and economic influence they might also have a tendency to protect other investors' interests and resist altering the earnings figures (Goldman et al., 2009). Accordingly, the research hypothesizes that:

H01: a higher proportion of royal family members on boards of directors decreases earnings management.

3.2. Female Director

As explained earlier, previous studies argue that the involvement of female directors has a negative effect on earnings quality (Adams and Ferreira, 2009; Smith et al., 2006) due to a lack of qualifications and skills needed for directorship. Thus, few women sit on boards and those that do are monitored closely. This leads to an increase in costs for the agency and a reduction in firm performance and value (Cashman et al., 2012; Falato et al., 2014; Field et al., 2014). Accordingly, the research hypothesizes that:

H02: a higher proportion of female directors on boards of directors increase earnings management

3.3. Independent Directors

The majority of studies claim that an independent director can be more accountable than an executive (Fama, 1980; Sonnenfeld, 2002) due to their independent judgment of board decisions (Cadbury report, 1992; Chhaochharia & Grinstein, 2009). In addition, Brickley et al. (1994), Byrd

and Hickman (1992) and Weisbach (1988) find that firms with more effective board monitoring have more independent directors. Accordingly, the research hypothesizes that:

H03: a higher proportion of independent members on boards of directors decreases earnings management.

4. METHODOLOGY

4.1. Sample selection

The key objectives for this paper is to examine the association between the Royal family on board member and earnings management. We used non-financial listed firms in GCC countries, resulting in 360 companies from 6 countries. The sample covered four years that start from 2010 to 2013, because of the availability of the data. The sample contained 1456 observations and the final observations 1440, because of missing data. The following paragraphs about the model, variables and measurements. As table 1 shows that the lowest observation is Bahrain, with 48 observations by 3.3%, and the highest observations are KSA with 432 observations by 30%.

Table 1: Sample of GCC Countries.

Country	Observations	Percent
Bahrain	48	3.3%
Qatar	84	5.8%
KSA	432	30%
Oman	312	21.7%
Kuwait	396	27.5%
UAE	168	11.7%
Total	1440	100%

Table 2: Sample Selection.

Sampling Procedures	Number of Observations
Full sample	1456
Missing data due to research criteria	16
The net sample used in the study	1440

The following model was used to measure earnings management by modified Jones model (1995), following (Ittonen et al., 2013).

$$\frac{TA_{it}}{AT_{it-1}} = \alpha_0 + \alpha_1 \left(\frac{I}{AT_{it-1}} \right) + \alpha_2 \left(\frac{(\Delta \Delta RE_{it} - \Delta AR_{it})}{AT_{it-1}} \right) + \alpha_3 \left(\frac{PPE_{it}}{AT_{it-1}} \right)$$

$$+ \text{year fixed effect} + \text{industry fixed effect} + e_{it}$$

Where TA_{it} is total accruals of company i , AT is total assets in the beginning of the year, ΔREV is revenues in year t minus revenues in year $t-1$, ΔAR_t is net receivables in year t less net receivables in year $t-1$ and PPE_t is the gross property, plant and equipment in year t . α_1, α_2 and α_3 are obtained by estimating the equation using each year and firm in the industry, and e_{it} it is the error term.

Prominent researchers recommend that it's difficult for outsiders to understand issues that happened inside (Dechow et al., 1995; Jones, 1991; Kothari et al., 2005; Alqatan, 2019). Further, earnings can be managed through short or long-term discretionary accruals (Arun et al., 2015). Becker et al., (1998) it is easier for managers to use short term accruals than long term accruals for managing earnings. Therefore, it's better to measure earnings management through short term accruals rather than long term accruals. The conclusion which most of the key authors draw that using a different type to measure earnings management won't make a change (Dechow et al., 1995; Jones, 1991; Kothari et al., 2005).

This study uses discretionary accruals measured by modified Jones (1995) model were chosen, because according to previous studies, the use of a different type of measurement for EM does not change the results (Dechow et al., 1995; Jones, 1991; Kothari et al., 2005). Furthermore, the modified Jones is generally used in the literature to measure discretionary accruals, facilitating this study's comparability (Fan et al., 2012; Arun et al., 2015; Shu et al., 2015; Gull et al., 2018; Jackson, 2018; Kim & Jung, 2020; Yu et al., 2020; Da Costa Gomes et al., 2021). This paper uses EM as the absolute value of discretionary accruals (Sun et al., 2010; Ittonen et al., 2013; Abdelwahed, 2018; Mo & Lee, 2021).

Measurement of royal family members on the board: someone may argue that the power of royal board members is differ from company to another based on the position of the royal board members. The practices in numerous companies in GCC countries is that royal family positioned in the board of director of most companies for two reasons: first: they are shareholders in the company and hold a high percentage of the share. Second, they appointed as honorary members mostly honorary chairman just for political connection. The honorary royal member on the board normally do not even attend most of the board meetings and do not have power in the board decisions. Rarely, the royal family appointed to the board of director based on the qualification and experience. We are aware of this issue regarding selection of royal family on the board of directors. However, due to limited availability of data of selection of royal family members on the board of directors. We adopted a rough measurement, which is their percentage of ownership in the company arguing that they are more likely to be the board due to their shares. Therefore, we collected the data of royal family when they have a percentage of share in the company.

4.2. Model and Variables

We used the model following Ittonen et al., (2013); Peni and Vahamaa, (2010); Zalata et al., (2018), Gull et al., (2018). This study added ROA as a control variable because the study expecting the company with high performance has low

EM. Besides, according to Chen et al. (2015) makes clear that fraud firms tend to present a lower performance. Also, this control variable affects earnings management, and that agreed many times by (Francis & Wang, 2004; Gonzalez et al., 2014).

$$EM = B_0 + B_1RD + B_2GD + B_3BID + B_4 FF + B_5DUAL + B_6R * GD + B_7R * BID + B_8R * FF + B_9R * DUAL + B_{10}BSZ + B_{11}SG + B_{12}CF + B_{13}CSZ + B_{14}L + B_{15}ROA + Country\ dummy + Years\ dummy + Industry\ dummy + \epsilon$$

Where:

EM is Earnings management; B_0 is Constant; B_1 RD is Royal family member on board of directors; B_2 GD is Gender diversity; B_3 BID is Board Independence; B_4 FF is Family firm; B_5 DUAL is Role Duality; B_6 $R * GD$ is Royal*Gender; B_7 $R*BID$ is Royal*Independent; B_8 $R*FF$ is Royal*Family firm; B_9 $R*DUAL$ is Royal*Duality; B_{10} BSZ is Board size; B_{11} SG is Sales Growth; B_{12} CF is Cash Flow; B_{13} CSZ is Firm size; B_{14} L is Leverage; B_{15} ROA is Return on Assets; ϵ is the error term.

Table 3. Summarizes the Main Variables, Which Study used, and their Measurements.

Variables	Measurements
Dependent	
Earnings management (EM)	Jones Model
Independent	
Royal Family (RD)	The ratio of royal directors to total board size
Control	
Gender Diversity (GD)	The ratio of women directors to total board size
Family firm (FF)	Dummy by Founder
Royal*Gender Diversity (R*GD)	Female Royal directors
Royal*Independent (R*BID)	Royal Independent directors
Royal*Family firm (R*FF)	Royal directors in Family firm
Royal*Duality (R*DUAL)	Royal directors work in two positions
Board size (BSZ)	Total number of directors
Board independent (BID)	The proportion of independent directors to total board
Duality (DUAL)	Dummy
Firm size (CSZ)	Total assets
Firm growth (FG)	Percentage change in aggregate sales
Cash Flow (CF)	Cash flow divided by total assets

Leverage (L)	Total debt divided by total equity.
ROA	Profits divided by total assets
Country name	Dummy
Industry type	Dummy
Year	Dummy

5. FINDINGS AND DISCUSSION

5.1. Descriptive Statistics

Table 4 shows the descriptive statistics of earnings management (EM), Royal family members on board (RD), Board size (BSZ); Board Independence (BID); Role Duality (DUAL); Sales Growth (SG); Cash Flow (CF); Company size (CSZ); Leverage (L); Return on Assets (ROA). The sample period starts from 2010 to 2013.

The table presents the total number of valid observation (Obs) represents 364 firms in the sample, the mean, standard deviation, the minimum and the maximum. Starting with the mean of EM, which means that the average value of absolute discretionary accrual is 0.027. The minimum value is zero, that indicates there are some companies of the sample don't have EM, and the maximum value of the companies that used EM is 0.201. The mean value of Royal family members on board (RD) that means the average value of royal directors on board member is 0.2, the minimum value is 0, which means there are companies don't have Royal director on board, and the maximum value is 0.2. The mean value of gender diversity on board (GD) is 0.13, the minimum is 0, which means there are companies don't have female on board, and the maximum is 0.6. The mean value of independent directors on board (BID) is 0.428, the minimum is 0, and the maximum is 1, which means there are some companies don't have any independent directors on board, and there are companies all their directors on board are independent directors. The average of family firm (FF) is 0.383, the minimum is zero and maximum is 1, and that means there are about %60 of non-financial firms are not family firms. The value of role duality (DUAL) is dummy (0 and 1), which means there are directors that role two positions which is CEO and board director in some companies, and there are companies that the directors on board member have one position in the come. The mean of female royal directors (R*GD) is 0, the minimum is 0, and the maximum is 0.003. The average is royal independent directors (R*BID) is 0.01, the minimum is 0, and the maximum is 0.182. The mean is royal independent directors (R*BID) is 0.01, the minimum is 0, and the maximum is 0.182. The average of royal directors in family firms (R*FF) is 0.01. We also find that on average of royal directors' work in two positions (R*DUAL) is 0.002. The average value of board size (BSZ) is 7.296, the minimum number is 2, and the maximum is 18, and that depends on the company size. The mean value of Sales growth (SG) is 7.42 that means the average value of the companies have profit from sales growth, the minimum value is -99.999, which means some companies loss in sales, and the maximum value is 1974.962, which means some companies have profit from sales growth. The average value of the cash flow (CF) is -

0.574, which means have cash deficit, the minimum value is -217.576, which means those companies have cash deficit, and the maximum value is 101.563, which means there are some firms have a cash surplus. The mean value of the company size measured by (total assets) is 10.153, and the minimum value is 0.522, and the maximum value is 16.172. The average value of leverage (L) is 15.654, which means the average of companies that have debt level, the minimum value is zero, and the maximum value is 720.935. Finally, the mean value of return on assets (ROA) is 0.29, which is a company profit. The minimum value is -48.645, that means those companies have losses, and the maximum value is 33.515, which is a profit.

Table 4. Descriptive Statistics.

Variable	Obs	Mean	Min	Max
EM	1456	.027	0	.201
Royal	1456	.02	0	.2
Gender	1456	.013	0	.6
Independent	1456	.428	0	1
Family firm	1456	.383	0	1
Duality	1456	.174	0	1
Royal*GD	1456	0	0	.003
Royal*Indep-t	1456	.01	0	.182

Table 5. Correlation Matrix.

Variables	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)	(13)	(14)	(15)	(16)
(1) EM	1.000															
(2) Royal	0.028	1.000														
(3) Gender	-0.089	-0.094	1.000													
(4) Independent	0.205	0.107	-0.254	1.000												
(5) family firms	0.067	0.121	-0.007	-0.073	1.000											
(6) Duality	-0.137	-0.090	0.219	-0.351	0.034	1.000										
(7) Royal*GD	-0.056	0.037	0.101	0.011	-0.026	-0.013	1.000									
(8) Royal*Independent	0.056	0.868	-0.080	0.243	0.090	-0.067	0.040	1.000								
(9) Royal*Family firm	0.016	0.704	-0.066	0.059	0.368	-0.014	-0.019	0.578	1.000							
(10) Royal*Duality	0.002	0.277	-0.027	0.050	0.121	0.263	-0.008	0.277	0.347	1.000						
(11) Board size	0.000	0.211	-0.168	0.234	0.019	-0.216	0.273	0.141	0.141	0.026	1.000					
(12) Sales Growth	-0.046	-0.041	0.051	-0.118	-0.032	0.068	-0.002	-0.035	-0.028	-0.011	-0.072	1.000				
(13) Cash Flows	0.035	0.024	-0.036	0.067	0.026	-0.037	0.003	0.020	0.016	0.007	0.032	0.000	1.000			
(14) Log Firm size	0.140	0.299	-0.307	0.593	-0.019	-0.412	0.044	0.242	0.217	0.077	0.549	-0.141	0.064	1.000		
(15) Leverage	-0.097	-0.126	0.143	-0.349	0.044	0.253	-0.011	-0.108	-0.086	-0.034	-0.225	0.077	-0.025	-0.442	1.000	
(16) ROA	0.003	-0.016	0.073	-0.052	0.021	0.017	0.005	-0.015	-0.012	-0.005	-0.036	-0.017	-0.013	-0.024	-0.074	1.000

Royal*Fam~m	1456	.01	0	.2
Royal*Duality	1456	.002	0	.143
Board size	1456	7.296	2	18
Sales Growth	1440	7.42	-99.999	1974.962
Cash Flows	1451	-.574	-217.576	101.563
Log Firm size	1456	10.153	.522	16.172
Leverage	1455	15.654	0	720.935
ROA	1456	.29	-48.645	33.515

5.2. Correlation Matrix

This paper conducted a sample correlation between the variables. Table 5 shows the result of correlation analysis, which is a correlation matrix that doesn't present any potential multicollinearity problems. According to Gujarati (2003); Gujarati & Porter (2009); Adkins et al. (2011); Ho & Wong (2001); Hair et al (2013, p. 196) that the highest r2 between any two independent variables is 90% or higher, and that will show a serious multicollinearity problem. Where the highest r2 is 86% between board independent and company size. Therefore, Table 5 shows a significant positive correlation between EM and BID, besides CSZ at 10%. Also, there is a significant negative correlation between EM and DUAL, besides L at 10%. However, there is no effect between EM and RD. In the end, these are initial results, and the final results will be in the multi-regression.

5.3. Multi Regression Analysis and Results

Table 6 shows the results from Tobit regression analysis for GCC countries combined, which is Absolute discretionary accruals as dependent variable is non-negative variables, that is why we used Tobit as main regression (Xiao et al., 2014). The natural log of RD as the independent variable, and GD, FF, R*GD, R*BID, R*FF, R*DUAL, BSZ, BID, DUAL, SG, CF, the natural log of CSZ, L, ROA, year dummy, industry dummy, and country dummy as control variables.

As Table 6 presents regression analysis results between earnings management and Royal family member on board in the GCC countries (EM and RD). The coefficient of RD variable is negative at %1 ($B1 = -3.342$) indicating that the royal family on board impact on EM. This is consistent with that found by majority of related studies such as (Sanchez and Meca, 2005; Muth and Donaldsoon, 1998; Hertog, 2012; Batta et al., 2014, Alghamdi and Ali, 2012; Al Nasser, 2018 and Goldman et al., 2009) who support to have significant negative relationship between royal family on board and earnings management.

Also, it consistent the arguments of leadership theory that Royal family members on the board of directors are more likely to inspire leaders to their employees to go beyond their self-interest and instead focuses on goals of the organization by mitigating or presenting earnings management. This also indicates that they may signalling the importance of corporate governance interm of minimizing the earing management and maxmizing the interest of shareholders to their leaders. This is also support previous literature that the politically connected member has a negative influence on firm earnings management (Faccio, 2010; 2006; Cheney et al., 2011; Fan et al., 2007).

Moreover, the result does support the resource dependent theory argument that the more board members have connections the more approach to different resources that increase the firm performance (Mizruchi & Stearns, 1988; Banerji & Sambharya, 1996; Frooman, 1999; Freeman & Evan, 1990; Pfeffer and Salancik (1978); Certo et al., 2001; Bazerman and Schoorman, 1983). Accordingly, we accept the study's hypotheses.

In related to control variables that the GCC regression analysis represents that there are significant negative at 1% with DUAL ($B5 = -0.148$) and at 1% with R*GD ($B6 = -380.0$) and there are significant positive on 5% relationship with BID ($B3 = 0.193$) and at %1 with FF ($B4 = 0.127$). Moreover, there are significant positive on 1% relationship with R*BID ($B7 = 5.039$), and % 10 with CSZ ($B13 = 0.0154$).

Table 7 present four an additional analysis which are OLS, and 2SLS, GMM and Lagged Independent to solve any endogeneity and causality problems. All the four analysis confirmed the main analysis that provide in Table 6, which all the four regression have a significant negative relationship between royal family on board and EM. Moreover, table 8 we change the measurement of royal family on board using a dummy that equals one for firms have royal family on their board, and zero otherwise. Table 8 used all the five regression which are Tobit, OLS, 2SLS, GMM and lagged independent, which confirm the result of table 6 and 7 and both theories

this study used, that there is a significant negation association between royal family on board and EM at % 1.

To conclude, the regressions' results highlight that RD negative affect earningsmanagement, confirmed by robust analysis that find a significant negative relationship for the royal family on board and earnings management. Having royal family on board mitigate using earnings management in GCC countries.

CONCLUSION

CG facilitates the company's system, reduces the firm's earning management, and protects the investor's rights, especially minority shareholders, which leads to enhance investors confidence and economic growth. Furthermore, CG is a widely accepted concept and has been adopted by most countries around the world. Despite its widespread use, CG has not been embedded perfectly in the emerging markets. As mentioned earlier, many recent financial failures and companies' issues have been caused by poor CG. Based on previous explanations, having reviewed the literature concerning the CG of GCC countries, this has not been explored in any depth. In fact, there is a dearth of literature in the region; but this paper conducted the investigation to address the gap and explored the CG practice and influence on the region. The objective of this research is to investigate the ability of royal family directors on reducing earnings management.

The study used a hand-collected dataset retrieved from company annual report and Capital IQ. Using several kind of regression analyses of non-financial publicly listed company in GCC countries, the findings is confirmed by several regression, besides after changing the measurement of royal family director on board the result still the same, which is a significant negative relationship between royal family director on board and earnings management. Our results indicate that the royal family members on the board mitigate the earnings management and play resource role for the firm. Our results are robust to different measures of the effect of royal family on the board on earnings management. The future research should develop this topic further by considering other monarchical regimes. Also, using real earnings management and classification shifting as other type to measure earnings management, besides, update the study period to 2021.

Table 6: VARIABLES	Tobit
Royal	-3.342***
Gender	-0.209
Independent	0.193**
Family Firm	0.127***
Duality	-0.148**
Royal*Gender	-380.0***
Royal*Independent	5.039***
Royal*Family Firm	0.146
Royal*Duality	1.459

Board size	-0.0193
Sales Growth	-9.06e-05
Cash Flows	-0.000324
Firm Size	0.0154*
Leverage	-0.000138
ROA	0.00342
Constant	-4.957***
Observations	1,440
Country FE	YES
Industry FE	YES
Year FE	YES

Standard errors in parentheses
 *** p<0.01, ** p<0.05, * p<0.1

Table 7	(1)	(2)	(3)	(4)
VARIABLES	OLS	2SLS	GMM	Lagged Independent
Royal	-3.342***	-3.342***	-3.342**	-1.674**
Gender	-0.209	-0.209	-0.209	-0.192
Independent	0.193**	0.193**	0.193**	0.242***
Family Firm	0.127**	0.127***	0.127***	0.139***
Duality	-0.148**	-0.148**	-0.148**	-0.138**
Royal*Gender	-380.0***	-380.0***	-380.0***	-385.1***
Royal*Independent	5.039***	5.039***	5.039***	2.501**
Royal*Family Firm	0.146	0.146	0.146	-0.609
Royal*Duality	1.459	1.459	1.459	1.611
Board size	-0.0193	-0.0193	-0.0193	-0.0201
Sales Growth	-9.06e-05	-9.06e-05	-9.06e-05	-8.02e-05
Cash Flows	-0.000324	-0.000324	-0.000324	-0.000384
Firm Size	0.0154	0.0154*	0.0154*	0.0141
Leverage	-0.000138	-0.000138	-0.000138	-0.000117
ROA	0.00342	0.00342	0.00342	0.00351
Constant	-3.644***	-4.957***	-4.957***	-3.649***
Observations	1,440	1,440	1,440	1,439
R-squared	0.163	0.163	0.163	0.162
Country FE	YES	YES	YES	YES
Industry FE	YES	YES	YES	YES
Year FE	YES	YES	YES	YES

Standard errors in parentheses
 *** p<0.01, ** p<0.05, * p<0.1

Table 8 Royalty Dummy	(1)	(2)	(3)	(4)	(5)
VARIABLES	Tobit	OLS	2SLS	GMM	Lagged Independent
Royalty	-0.484***	-	-	-	-0.226***
Gender	-0.215	-0.215	-0.215	-0.215	-0.195
Independent	0.179**	0.179*	0.179**	0.179*	0.238***
Family Firm	0.127***	0.127***	0.127***	0.127***	0.140***
Duality	-0.152**	-0.152**	-0.152**	-0.152**	-0.139**
Royal*Gender	-330.7**	-330.7**	-330.7**	-	-368.0***
Royal*Independent	5.308***	5.308***	5.308***	5.308***	2.488**
Royal*Family Firm	0.0984	0.0984	0.0984	0.0984	-0.643
Royalty*Duality	1.642	1.642	1.642	1.642	1.584
Board size	-0.00849	-0.00849	-0.00849	-0.00849	-0.0167
Sales Growth	-9.13e-05	-9.13e-05	-9.13e-05	-9.13e-05	-8.03e-05
Cash Flows	-0.000259	-	-	-	-0.000356
Firm Size	0.0151	0.0151	0.0151	0.0151*	0.0142
Leverage	-0.000145	-	-	-	-0.000121
ROA	0.00342	0.00342	0.00342	0.00342	0.00349
Constant	-4.963***	-	-	-	-3.654***
Observations	1,440	1,440	1,440	1,440	1,439
R-squared		0.167	0.167	0.167	0.163
Country FE	YES	YES	YES	YES	YES
Industry FE	YES	YES	YES	YES	YES
Year FE	YES	YES	YES	YES	YES

Standard errors in parentheses
 *** p<0.01, ** p<0.05, * p<0.1

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