Research in International Business and Finance 39 (2017) 1–12

Contents lists available at ScienceDirect

Research in International Business and Finance

journal homepage: www.elsevier.com/locate/ribaf

Full length article

Corporate governance and cash holdings in MENA: Evidence from internal and external governance practices

Basil Al-Najjar[a,*], Ephraim Clark[b]

[a] Birkbeck College, University of London, London WC1E 7HX, United Kingdom
[b] Middlesex University, London, NW4 4BT, United Kingdom

ARTICLE INFO

Article history:
Received 21 January 2016
Accepted 18 July 2016
Available online 19 July 2016

Keywords:
External governance
Board size
Board independence
Institutional ownership
MENA
Cash holdings

ABSTRACT

This paper explores the impact of internal and external corporate governance practices on the decision to hold cash in MENA countries. Using430 non-financial firms in the MENA region for the period from 2000 to 2009, we find that both types of governance practices are important. We report a negative relationship between board size and cash holdings, evidence that firms hold less cash to reduce agency conflicts. Also, we detect that external governance activities are important in cash holding decisions, since we report that firms belonging to countries with international standards of securities law and bank supervision hold less cash. For our sub-sample of 85 firms, we report evidence that institutional owners are seen to be self-opportunistic and that they aim to maximize their own private benefits.

© 2016 Published by Elsevier B.V.

1. Introduction

This paper investigates the issue of corporate governance and financial policy in the Middle-East and North African (MENA) countries. Corporate governance refers to the system of rules, practices and processes by which a company is directed and controlled. As such, governance structures and principles identify the distribution of rights and responsibilities across the various stakeholders in the corporation. A major issue in the study of corporate governance is the potential conflict of interest between shareholders and professional managers. This well known "agency" conflict arises from the fundamental differences in the positions of the shareholders that own the firm and the managers that control the firm's assets. Managers typically have much of their human capital and financial wealth invested in the firm, while shareholders are typically more diversified and less exposed to the specific risk of an individual firm (Fama, 1980 Stulz and Smith, 1985). This principal-agent conflict is the source of decisions that lead to the sub-optimal use of a firm's resources when under-diversified, risk-averse managers seek to reduce their personal exposure at the expense of shareholders. Proper corporate governance mechanisms are thus crucial in resolving this conflict by aligning the interests of shareholders and managers (Lasfer, 2006).

Cash holdings are particularly adapted to the study of corporate governance and the principal-agent conflict of interest because the decision to deploy or accumulate cash in excess of the amounts necessary for normal business transactions and any ongoing contractual obligations is largely at the discretion of managers with limited scope for external scrutiny. Thus, as Jensen (1986), Kim et al. (1998), Opler et al. (1999) and Ozkan and Ozkan (2004) have emphasized, the propensity

* Corresponding author.
E-mail addresses: b.al-najjar@mdx.ac.uk (B. Al-Najjar), E.Clark@mdx.ac.uk (E. Clark).

http://dx.doi.org/10.1016/j.ribaf.2016.07.030
0275-5319/© 2016 Published by Elsevier B.V.

for accumulated cash to lower firm risk makes it an excellent instrument for a manager seeking to implement personally advantageous corporate policies that are inconsistent with the risk preferences of shareholders.

However, empirical conclusions on the relationship between cash holdings and corporate governance that have focused on the developed economies are generally inconclusive. Several studies have investigated cash holdings in the US framework (Opler et al., 1999; Dittmar and Mahrt-Smith, 2007); the EMU framework (Ferreira and Vilela, 2004); the UK framework (Ozkan and Ozkan, 2004; Al-Najjar and Belghitar, 2011); the Spanish SMEs context (Garcia-Teruel and Martinez-Solano, 2008). Al-Najjar (2012) examined the financial determinants in some emerging markets but without including corporate governance in his models. Indeed, our aim, here, is to bridge this gap and investigate whether internal governance mechanisms, such as board size and independence, and external mechanisms, such as good governance procedures, fiscal policy transparency and securities law and banking supervision, affect the decision to stockpile cash in such markets. Unlike previous studies that investigate cash holdings, we provide evidence on the impact of both internal and external corporate governance mechanisms on cash holdings.

Our sample consists of nine Middle-East and North African (MENA) stock markets. Several reasons justify this focus. First, because these countries are integrated into the European Union's neighbourhood policy, they share a common economic reform trajectory.[1] However, they also reflect differing levels of development and financial reform. Thus, they provide fertile ground for a comparative analysis linking corporate governance and cash holdings.

Second, disclosure practices in the region are widely perceived as being generally comparable to those in other emerging markets (OECD, 2013). However, the MENA ownership structure has the particularity that the majority of companies listed on MENA bourses are characterised by the presence of controlling shareholders in the form of government investors (SWFs, public pension funds, security funds, etc.) or other founding shareholders, typically families. Finally, there is also enough diversity to allow comparative analysis. For instance, in the Gulf countries and Jordan, corporate governance codes encompass fundamental requirements regarding the composition of the board, the conduct of AGMs, the reporting to shareholders and other dimensions. In other countries of the region, such as Egypt, codes remain voluntary and the companies and securities laws and regulations are the primary source of governance requirements.

Third, whereas much academic research has looked at corporate governance in other emerging markets, corporate governance in the MENA region has generally been neglected. For example, in their international sample of 45 countries, Dittmar et al. (2003) include only Jordan and Egypt of MEN Ramirez and Tadesse (2009) include only Egypt in their international dataset. Otherwise, to the best of our knowledge, there is no other evidence on cash holdings and corporate governance in the MENA countries.

We contribute to the extant literature in different ways. First, this is the first major empirical study to explore the MENA context. Second, unlike the previous literature, we include both internal and external governance mechanisms in our study. We find that they affect the level of cash holdings both separately and jointly. Third, we provide this evidence using a unique updated dataset for the period from 2000 to 2009, which provides us with the largest firm-year observation sample for these countries.

Our results can be summarized as follows. Where internal mechanisms are concerned, we find a negative relationship between board size and cash holdings, which is evidence that large boards are active and they tend to reduce the manager-shareholder agency conflict. Where external mechanisms are concerned, the evidence is inconclusive. Firms that belong to countries with international standards of securities law and bank supervision hold less cash. However, firms in countries that enjoy "fiscal transparency" and good governance practices hold more cash. We also report that the interaction between external and internal governance mechanisms weakens board activity. Moreover, we detect that institutional investors in MENA are not as active as they should be. Finally, we find that firm size, profitability, and capital structure are important determinants of holding cash in our sample.

The rest of the paper is organized as follows. Section 2 provides the theoretical framework. Section 3 discusses the data and methodology. Section 4 presents the results. Section 5 concludes the study and discusses the empirical implications of the findings.

2. Theoretical framework

In this section we present the theoretical framework adopted in this study. We start with the theory of corporate governance in the context of the principle-agent conflict of interest, and then provide a discussion of the trade-off and pecking order theories of capital structure.

2.1. Agency theory

Agency theory argues that firms with high levels of free cash flows can suffer the consequences of agency conflicts if this cash is not used to invest in profitable projects. Managers can boost their own interests by stockpiling cash to obtain discretionary power, thereby giving rise to agency conflicts between managers and shareholders (Jensen, 1986). Chen (2008) also argues that managers will enjoy higher discretionary power in firms that hold high levels of cash. In the same vein,

[1] See Lagoarde-Segot and Lucey (2008).

Download English Version:

https://daneshyari.com/en/article/1002864

Download Persian Version:

https://daneshyari.com/article/1002864

Daneshyari.com