

Midocean University

College of Management

Department of Business Administration



**Effect of Corporate Governance on Increasing Foreign Direct Investment
in Saudi Arabia**

Rasha Mohammed Alamri

241000987

Supervisor

Dr. Asma Abuanzeh

The Second Semester Of Year 2024

Abstract

This research paper provides a deep understanding of the impact of corporate governance in increasing foreign direct investment in the Kingdom of Saudi Arabia. This is by investigating how various aspects of corporate governance such as ownership structure, accountability, transparency as well as board composition affect the decisions of foreign investors. In addition, the study examines the relationship between these factors to increase investor confidence to invest in the Saudi market. Moreover, the role of Saudi Vision 2030 to increase economic diversification will be discussed in advance to reach the relationship between corporate governance and foreign direct investments. The research will include a lot of questions and hypotheses to cover the topic from different perspectives adequately as shown below to reach how corporate governance practices can improve the foreign direct investment in Saudi Arabia.

➤ **Table of contents**

- Abstract

Part (1)

- Introduction
- The problem of the study
- The importance of the study
- The research objectives
- The research questions
- Hypotheses of the study

Part (2)

- Research Methodology
- Research tools
- Research limitations

Part (3)

- Literature review

1 - The impact of the suitable of ownership structure on increasing feign direct investment (FDI)

2 – The impact of the independence of board members in increasing foreign direct investment

3 - Having long term plans is associated with increasing the level of confidence of foreign investors

4 – The relationship between corporate governance and foreign direct investment

5 – Ways to improve the corporate governance principles

6 – Relationship between foreign direct investment and Saudi Vision 2030

Part (4)

- List of references

➤ **Part (1)**

Introduction

The era of globalization determines utilizing opportunities to enhance the economy well, so foreign direct investment is shown to be an effective tool for economic growth. The Kingdom of Saudi Arabia in advance seeks towards utilizing foreign direct investment to diversify the Saudi economy and increase the development opportunities. However, convincing foreign investors to invest in a new market needs to create a good environment full of trust and confidence which is suitably made by corporate governance. This is by finding that effective corporate governance can enhance a transparent, responsible and accountable framework for businesses and reduce risks. Furthermore, the Saudi Vision 2030 seeks social reforms to increase foreign direct investment. The following lines will provide deep insights into the effect of corporate governance on increasing foreign direct investment in Saudi Arabia.

The problem of the study

Despite having a great alignment between the Saudi Vision 2030 and foreign investment, the Kingdom faces some challenges regarding attracting suitable foreign direct investment. That leads the research paper to tackle the following problem to identify the appropriate requirements for creating an attractive environment for foreign investment:

- To what extent do corrupt corporate governance practices in the Kingdom of Saudi Arabia hinder or enhance foreign direct investment?

The importance of the study

The study is important for the following reasons:

- 1 – Providing clarification to increase the foreign direct investment
- 2 – Strengthening the corporate governance practices to enhance the investor confidence
- 3 – Being an effective tool for supporting Vision 2030 by aligning the corporate governance practices with foreign investors' needs to witness an economic transformation

The research objectives

This research paper aims to measure the effect of corporate governance on increasing foreign direct investment in the Kingdom of Saudi Arabia through tackling the following points:

- 1 – investigate the effect of ownership management on foreign direct investment in the Kingdom of Saudi Arabia
- 2 – Measure the effect of board composition on FDI decisions
- 3 – identify the role of executive compensation structures in increasing foreign direct investment to align the interests between management and shareholders
- 4 – Provide deep understanding of the relationship between the corporate governance and foreign direct investment in Saudi Arabia
- 5 – Recommend adequate practices that can enhance corporate governance in Saudi Arabia to attract foreign investors

6 – Participate in increasing the success of Vision 2030 by highlighting the strong impact between corporate governance to increase the foreign direct investment to achieve the vision.

The research questions

1 – Does the suitable ownership structure increase the foreign direct investment in Saudi Arabia?

2 – How does the independence of board members impact the perception of accountability by foreign investors?

3 - How do long term plans affect the level of confidence by foreign investors?

4 – To what extent does the strong corporate governance impact the foreign investors?

5 – What are the recommendations for improving the corporate governance to increase foreign investors?

6 – How does the foreign direct investment align with the Saudi Vision 2030?

Hypotheses of the study

H 1: The strong ownership structure plays a vital role in increasing the foreign direct investment in Saudi Arabia

H 2: The independence of board members is aligned with increasing foreign direct investment

H 3: Having long term plans is associated with increasing the level of confidence of foreign investors

H 4: The strong corporate governance including having encompassing ownership structure, board composition and executive compensation can attract foreign direct investment in Saudi Arabia

H 5: Addressing weaknesses and improving the corporate governance framework in Saudi Arabia paves the way to flourish the foreign investment in the Kingdom of Saudi Arabia adequately.

H 6: There is a great relationship between increasing foreign direct investment and achieving the Saudi Vision 2030.

➤ **Part (2)**

Literature review

1 - The impact of the suitable of ownership structure on increasing foreign direct investment (FDI)

A suitable ownership structure can support increasing foreign direct investment. First, it plays a vital role in reducing risks by controlling the businesses and offering a suitable framework for full control over decision-making. In addition, the effective structure of ownership helps increase transparency and accountability by building trust and encouraging foreign investors to enter the market. In addition, it can increase flexibility by matching expertise to attract foreign investors with specific needs. Transferring knowledge with collaboration can lead to knowledge transfer by sharing the best practices and managing skills with local partners to enhance the overall business environment¹. That

¹ Hadi Salehi Esfahani, Elizabeth Asiedum (2001), Ownership Structure In Foreign Direct Investment Projects, Review of Economics and Statistics 83(4):647-662, DOI:10.2139/ssrn.152570

leads the Kingdom of Saudi Arabia to create suitable ownership structures by working hard to align the ownership structures with international standards to make Saudi companies be aligned with international standards to be more attractive to foreign investors seeking global partnerships and market access. The Kingdom also sets long-term plans to allow foreign ownership in the Kingdom of Saudi Arabia like technology and manufacturing until achieving Saudi Vision 2030. Moreover, the Saudi government exerts great efforts for reforming the foreign investment regulations to facilitate foreign ownership². To sum up, the suitable ownership structure provides adequate control, transparency and flexibility to attract foreign direct investment in Saudi Arabia.

2 – The impact of the independence of board members in increasing foreign direct investment

The independence of board members plays a vital role in attracting foreign investors' perception of the accountability of the company for many reasons. First, it can reduce conflicts of interest by having an adequate framework for making objective decisions. This is by increasing the long-term health of the company as well as the value of the shareholders which in advance paves the way to foster trust with foreign investors³. In addition, it can enhance security and oversight. That is by giving a great power to increase a more transparent and accountable framework for foreign investors by following suitable ethical conduct. Moreover, the strong corporate governance practices including having an effective

² Amine Mati, Sidra Rehman, (2023), Saudi Arabia's Economy Grows as it Diversifies, international monetary fund blog, <https://www.imf.org/en/News/Articles/2023/09/28/cf-saudi-arabias-economy-grows-as-it-diversifies>

³ Ahmad Hakimi Tajuddin, Shabiha Akter, Rasidah Mohd-Rashid and Waqas Mehmood, (2023), The influence of board size and board independence on triple bottom line reporting, The current issue and full text archive of this journal is available on Emerald, <https://www.emerald.com/insight/1985-9899.htm>

independent framework of board members can increase the global standard alignment which makes them more attractive to foreign investors⁴. The Kingdom of Saudi Arabia works hard to utilize this opportunity by setting and implementing regulations that aim to strengthen board independence. This in advance leads the Capital Market Authority (CMA) to require listing companies with at least two or one-third of independence to signify a move towards a more independent board structure. In other words, the Kingdom of Saudi Arabia steps to promote board independence to increase accountability and properly exercise their oversight role.

3 - Having long term plans is associated with increasing the level of confidence of foreign investors

Long-term plans play a vital role in attracting foreign investors as they reduce risks and demonstrate stability and predictability in a country's economic and political environment. This in advance reduces the risk of sudden changes which paves the way to reach long-term economic growth as well as making investment more attractive. In addition, transparency and trust can create a healthy business environment for increasing success and development. That means long-term plans create an effective future for foreign investment by boosting economic growth and development⁵. The Kingdom of Saudi Arabia has in advance adopted ambitious programs with long-term plans for improving economic diversification and decreasing the dependence on the oil industry. These programs look to reduce risks to increase financial stability and have a diversified economy for a more

⁴ Bakr Al-Gamrh, Redhwan Al-dhamari, Akanksha Jalan, Asghar Afshar Jahanshahi, (2020), The impact of board independence and foreign ownership on financial and social performance of firms, Journal of Applied Accounting Research 21(2):201-229, DOI:10.1108/JAAR-09-2018-0147

⁵ countries participating in the freedom of investment process, (2009), Building Trust and Confidence in International Investment, OECD, <https://www.oecd.org/daf/inv/investment-policy/42446942.pdf>

effective future. In addition, the Saudi government seeks to reach strong growth potential by finding Saudi Vision 2030 focuses on developing new sectors such as tourism, technology and renewable energy to create new opportunities for foreign investors. Moreover, transparency and trust become a part of the Saudi vision and plans to reform the framework and create a welcoming environment for foreign businesses⁶.

4 – The relationship between corporate governance and foreign direct investment

There is a strong and positive relationship between corporate governance and foreign direct investment. This is by finding the strong corporate governance practices make a country be more attractive to foreign investors by increasing the level of transparency and accountability. This is by creating clear disclosure practices and independent oversight assuring that investments are being managed responsibly to reduce fraud and mismanagement well. This in advance paves the way to fulfill any gaps by finding foreign investors become informed with all decisions with all means of transparency⁷. In addition, it increases minority by finding the good governance ensures the rights of investors until making foreign investors become more confident that their interests are considered⁸. The second importance is concerned with finding corporate governance can reduce investment risks so foreign investors become be more interested in investing in countries that follow corporate governance plans. In other words, effective governance structures reduce the risk of managers which reduces harm investor returns.

⁶ Go-Globe staffm (2024), Saudi Arabia Vision 2030 — Goals and Objectives, Go-Globe, <https://www.go-globe.com/saudi-arabia-vision-2030-goals-and-objectives/>

⁷ Joshi S, kansil R., (2023), linkage between corporate governance, foreign direct investment and economic growth – empirical evidence from India, https://link.springer.com/chapter/10.1007/978-981-99-3401-0_4

⁸ Ernest Tslie Agbokah, David Boohene, Emmanuel Marfo, Joseph Asante Darkwah, (2022), Corporate Governance and Foreign Direct Investment in Sub- Saharan Africa, DOI: 10.6084/m9.figshare.22647655

Companies with good governance are able to access capital at lower costs as investors perceive them as less risky. The third impact is concerned with having overall improved investment climate by making the institutions become stronger with a well-established framework. This leads to improve the long-term performance with sustainable returns on their interests and enhance reputation to open new doors to new markets and partnerships⁹. To sum up, the good corporate governance practices can create a more effective and attractive environment for foreign investors by increasing the level of trust, reducing risks and fostering a stable and healthy business climate which paves the way to make investment opportunities become more profitable.

That leads the Kingdom of Saudi Arabia and its companies to adopt corporate governance practices to enhance the foreign direct investment. The corporate governance in Saudi Arabia has a great focus by applying transparency, accountability and protecting shareholder rights. The companies' law has run all the businesses operating in Saudi Arabia adequately. The Capital Market Authority (CMA) regulations include mandatory for companies listed on the Saudi stock exchange (Tadawul). The Ministry of Commerce (MOC) also seeks towards giving voluntary guidelines for non-listed companies along with providing a framework for good practices. The Saudi environment also encourages applying the corporate governance as the Islamic principles are aligned with it. Shariah principles of fairness, accountability and transparency also fit the corporate governance principles. Board structure and disclosure requirements are completely aligned with the financial transparency. That leads the current trends be directed towards increasing the

⁹ K. Batu Tunay, Serhat Yüксе, (2017), The relationship between corporate governance and foreign ownership of the banks in developing countries, Vol. 62. Núm. 5. Páginas 1627-1642, DOI: 10.1016/j.cya.2017.05.007

security by making investors have more transparency and accountability. Regulators are placing a greater emphasis on enforcing corporate governance. That leads the business in the Kingdom of Saudi Arabia meets the international standards until making the country be attractive for the foreign investors¹⁰.

5 – Ways to improve the corporate governance principles

There are different ways can pave the way to flourish foreign direct investment by improving the corporate governance framework. First, it is important to strengthen the regulatory framework by increasing standardization, enforcement mechanisms and independence of directors. Standardization means unifying the regulations for listed and non-listed companies under the CMA to create a clearer and more consistent framework. The improvement of regulations must focus on minority shareholder rights to focus on combatting *wasta* which has a long cultural history in the Kingdom of Saudi Arabia. Enforcement mechanisms develop stronger enforcement mechanisms to increase companies' efficiency with more independent oversight perspectives by following suitable regulations and effective penalties¹¹. The independence of directors can be also effective in reducing conflicts and promoting objective decision-making¹². In addition, there should be more transparency and disclosure framework by providing detailed reporting, increasing auditing standards and implementing whistleblower protection. Utilizing the independent media to provide greater corporate practices and improve the data accessibility to increase

¹⁰ Hend Alregab, (2021), The role of corporate governance in attracting foreign investment: An empirical investigation of Saudi-listed firms in light of vision 2030, <https://doi.org/10.1002/ijfe.2420>

¹¹ Michael Volkov ,(2013), Five Steps to Improve Corporate Governance, volkov law blog, <https://blog.volkovlaw.com/2013/01/five-steps-to-improve-corporate-governance/>

¹² AI and the LinkedIn community, (2024), What are the most effective ways to improve corporate governance practices?, LinkedIn, <https://www.linkedin.com/advice/0/what-most-effective-ways-improve-corporate>

investor education before making investment decisions. That is by making companies provide suitable financial reporting including information on environmental, social and governance practices. The standards should be strengthened to ensure the accuracy and reliability of financial statements along with implementing whistleblower protection mechanisms to encourage employees to report any illegal activities or unethical practices without fear which increases the level of transparency in advance¹³.

Moreover, promoting the culture of accountability has to be aligned with shareholder activism by supporting the development of it for enhancing its governance practices with executive compensation to have long-term performance metrics rather than short-term gains to decrease the risky behavior. Sustainability can be enhanced with corporate governance frameworks to increase the level of responsibility for business practices. Promoting a culture of long-term growth provides great is also recommended by focusing on ESG which means integration between environmental, social and governance until witnessing sustainable long-term growth of businesses. The board evaluation must be more cautious about implementing regular and independent board evaluations to identify areas for improvement and access effectiveness. This determines providing succession planning across companies to ensure smooth leadership transitions¹⁴. Furthermore, it is important to raise public awareness about the importance of corporate governance for reaching a healthy business environment and improve investor confidence. This can be more effective in case of utilizing technology to improve the level of data transparency and

¹³ Kezia Farnham, (2023), 11 effective corporate governance best practices to implement now, diligent blog, <https://www.diligent.com/resources/blog/best-practices-for-corporate-governance>

¹⁴ Mark Twain, (2021), Ten Steps to Improving Your Corporate Governance, ibabs, <https://www.ibabs.com/en/board-meetings/ten-steps-to-improving-your-corporate-governance/>

enhance communication with stakeholders. Continuous improvement should be utilized by focusing on reviewing and updating governance structures and practices along with fostering collaboration between the public and private sectors to implement the best practices. Benchmarking is also attractive by encouraging companies to utilize governance practices. Applying these recommendations can play a vital role in creating a robust and internationally recognized corporate governance framework that fosters long-term economic growth that attracts foreign direct investment with trust and transparency by increasing the level of confidence among foreign investors¹⁵.

6 – Relationship between foreign direct investment and Saudi Vision 2030

There is a strong and mutually beneficial relationship between foreign direct investment and Saudi Vision 2030. The Saudi Vision 2030 includes various goals including economic diversification to reduce dependence on oil and develop new industries by bringing expertise technology and new industries for achieving diversification. Another goal is related to increasing private sector contribution with a bigger role for the private sector in the economy such as encouraging foreign direct investment¹⁶. This is by finding it fosters competition innovation and job creation which strengthens the private sector. The third aim is related to improving the welfare and efficiency of people's lives by increasing knowledge transfer until they are ready to develop their own technological capabilities and workforce skills¹⁷. That makes increasing the foreign direct investment play a vital role in

¹⁵ Ralph Hohls, (2023), Five Ways to Improve Corporate Governance, LinkedIn, <https://www.linkedin.com/pulse/five-ways-improve-corporate-governance-board-portal-specialist>

¹⁶ Mohammed Alharbi, (2023), foreign investment attracted by Saudi Arabia, SSRN, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4357486

¹⁷ Chloe Domat, (2024), Saudi Arabia Opens Its Doors, global finance, <https://gfmag.com/economics-policy-regulation/saudi-arabia-opens-its-doors/>

achieving the Saudi Vision 2030 well. First, the Saudi Vision 2030 aims to raise the contribution of foreign direct investment to GDP from 3.8% to reach the global average of 5.7% to support achieving this goal. In addition, the national investment strategy is a key component of Saudi Vision 2030 to attract foreign direct investment by offering regular incentives and improving the investment environment¹⁸. This prioritizes shedding light on different factors such as tourism, manufacturing and renewable energy which makes foreign direct investment crucial for attracting investment. This in advance makes foreign direct investment become a more open and investor-friendly environment to attract foreign companies. In addition, it increases the level of level of transparency and accountability to attract foreign companies that reduce risks for foreign investors¹⁹. The megaprojects can be supported as well by providing a large-scale infrastructure project to present significant investment opportunities to attract foreign direct investment. The Saudi Arabia faces competition for reaching regular improvement to attract foreign direct investment. That means foreign direct investment becomes a critical driver for achieving the goals of Saudi Vision 2030. This in advance is a more attractive investment environment and focuses on the key factors that the Kingdom of Saudi Arabia seeks towards attracting more foreign investment, leading to economic diversification, job creation and long-term growth. That needs a skilled workforce to attract and benefit from foreign direct investment leading to economic diversification, job creation and long-term growth.

¹⁸ Majed Alharthi, (2022), Factors of foreign direct investment inwards: The case of Saudi Arabia, ideas blog, <https://ideas.repec.org/p/sek/iefpro/13015491.html>

¹⁹ Abdel-Mahmoud Abdel-Rahman , (2002), The Determinants of Foreign Direct Investment in The Kingdom of Saudi Arabia, https://www.researchgate.net/publication/46453283_The_Determinants_of_Foreign_Direct_Investment_in_The_Kingdom_of_Saudi_Arabia

➤ **Part (3)**

Research Methodology

This study will include a mixed-methods approach by utilizing both quantitative and qualitative ways for collecting data. This is by collecting data about the topic from different reliable sources. The quantitative data will measure the historical data on FDI in the Kingdom of Saudi Arabia. This is by providing a survey to collect the opinions about this topic. In addition, the qualitative data includes semi-structured interviews regarding the perceived impact of corporate governance on foreign direct investment decisions.

Research tools

1 – Databases will include accessing to different historical data on foreign direct investment in the Kingdom of Saudi Arabia from different reliable sources such as World Bank databases, Saudi Arabian Monetary Authority (SAMA) databases and academic journals that have discussed the topic before.

2 – Survey instrument will be used as a main tool for gathering the quantitative for the study

3 – Semi-structured interviews will be utilized for reaching much understanding of the topic for reaching qualitative data.

Research limitations

The research may be limited by the availability of reliable and comprehensive data on corporate governance in the Kingdom of Saudi Arabia. The interviews might be influenced by the interviewees' positions and perspectives

Ethical considerations

- 1 – informing all participants in the interview and survey about the purpose of the study, data usage and participant rights
- 2 – Confidentiality will be ensured for all the responses such as removing names and other identifying details.
- 3 – Data collection, analysis and management will be done with all means of objectivity and accuracy
- 4 – Providing voluntary participation with improving all levels of comfortability
- 5 – Designing the questions that avoid sensitive topics along with insuring objectivity during interview questions.

➤ **Part (4)**

List of references

1. Abdel-Mahmoud Abdel-Rahman , (2002), The Determinants of Foreign Direct Investment in The Kingdom of Saudi Arabia, https://www.researchgate.net/publication/46453283_The_Determinants_of_Foreign_Direct_Investment_in_The_Kingdom_of_Saudi_Arabia
2. Ahmad Hakimi Tajuddin, Shabiha Akter, Rasidah Mohd-Rashid and Waqas Mehmood, (2023), The influence of board size and board independence on triple bottom line reporting, The current issue and full text archive of this journal is available on Emerald, <https://www.emerald.com/insight/1985-9899.htm>
3. AI and the LinkedIn community, (2024), What are the most effective ways to improve corporate governance practices?, LinkedIn, <https://www.linkedin.com/advice/0/what-most-effective-ways-improve-corporate>
4. Amine Mati, Sidra Rehman, (2023), Saudi Arabia's Economy Grows as it Diversifies, international monetary fund blog, <https://www.imf.org/en/News/Articles/2023/09/28/cf-saudi-arabias-economy-grows-as-it-diversifies>
5. Bakr Al-Gamrh, Redhwan Al-dhamari, Akanksha Jalan, Asghar Afshar Jahanshahi, (2020), The impact of board independence and foreign ownership on financial and social performance of firms, Journal of Applied Accounting Research 21(2):201-229, DOI:10.1108/JAAR-09-2018-0147
6. Chloe Domat, (2024), Saudi Arabia Opens Its Doors, global finance, <https://gfmag.com/economics-policy-regulation/saudi-arabia-opens-its-doors/>

7. countries participating in the freedom of investment process, (2009), Building Trust and Confidence in International Investment, OECD, <https://www.oecd.org/daf/inv/investment-policy/42446942.pdf>
8. Ernest Tslie Agbokah, David Boohene, Emmanuel Marfo, Joseph Asante Darkwah, (2022), Corporate Governance and Foreign Direct Investment in Sub-Saharan Africa, DOI: 10.6084/m9.figshare.22647655
9. Go-Globe staffm (2024), Saudi Arabia Vision 2030 — Goals and Objectives, Go-Globe, <https://www.go-globe.com/saudi-arabia-vision-2030-goals-and-objectives/>
10. Hadi Salehi Esfahani, Elizabeth Asiedum (2001), Ownership Structure In Foreign Direct Investment Projects, Review of Economics and Statistics 83(4):647-662, DOI:10.2139/ssrn.152570
11. Hend Alregab, (2021), The role of corporate governance in attracting foreign investment: An empirical investigation of Saudi-listed firms in light of vision 2030, <https://doi.org/10.1002/ijfe.2420>
12. Joshi S, kansil R., (2023), linkage between corporate governance, foreign direct investment and economic growth – empirical evidence from India, https://link.springer.com/chapter/10.1007/978-981-99-3401-0_4
13. K. Batu Tunay, Serhat Yüксе, (2017), The relationship between corporate governance and foreign ownership of the banks in developing countries, Vol. 62. Núm. 5. Páginas 1627-1642, DOI: 10.1016/j.cya.2017.05.007
14. Kezia Farnham, (2023), 11 effective corporate governance best practices to implement now, dilifent blog, <https://www.diligent.com/resources/blog/best-practices-for-corporate-governance>

15. Majed Alharthi, (2022), Factors of foreign direct investment inwards: The case of Saudi Arabia, ideas blog, <https://ideas.repec.org/p/sek/iefpro/13015491.html>
16. Mark Twain, (2021), Ten Steps to Improving Your Corporate Governance, ibabs, <https://www.ibabs.com/en/board-meetings/ten-steps-to-improving-your-corporate-governance/>
17. Michael Volkov ,(2013), Five Steps to Improve Corporate Governance, volkov law blog, <https://blog.volkovlaw.com/2013/01/five-steps-to-improve-corporate-governance/>
18. Mohammed Alharbi, (2023), foreign investment attracted by Saudi Arabia, SSRN, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4357486
19. Ralph Hohls, (2023), Five Ways to Improve Corporate Governance, LinkedIn, <https://www.linkedin.com/pulse/five-ways-improve-corporate-governance-board-portal-specialist>