# The role of political connections in corporations: The case of a monarchical system

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#### ABSTRACT

This thesis investigates the impact of firms' political connections in three different aspects. The first study focuses on the impact of firms' political connections on their profitability. It shows the importance of recognising the political ruling system of the study context when defining which firm is politically connected, as the power holders who are able to affect firms' performance are linked to the ruling system. The study context is characterised by examining countries under monarchical rule. The first study shows that members royal families in the Gulf Country Council (GCC) are influential and powerful, whereas the powers of ministers and members of parliament are limited. Thus, firms' connections to royal families show positive and significant effects on their performance and profitability, whereas the connection with non-royal politicians is not statistically significant.

The second study focuses on the effect of firms' political connections on their capital structure. In line with the results of the first study, this study finds that connections with non-royal politicians are not statistically significant, whereas connections with the members of the royal family result in a lower level of leverage, which is explained by royal family members reflecting national culture the study context that discouraged obtaining debts.

The third study deals with the political crisis of June 2017 in the GCC region, which led to the collapse of political relations between the countries of the region and a blockade imposed on Qatar. The research found that the crisis had a greater negative impact on companies connected with members of the royal families than non-connected firms. Also, consistent with the results of the first and second studies, connections with non-royal family politicians were not statistically significant. The

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results demonstrate that investors and traders in the stock market place value on the connection with royal family members, as they are considered to be a source of power and a means of securing vital resources for firms.

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#### Abbreviations or symbols Table

Abbreviations or symbols	Name or Definition
MPs	Members of the parliament
RDT	Resource Dependence Theory
AR	Abnormal Return
CAR	Cumulative Abnormal Return
CAR [-1+ 0 +1]	The abnormal return for the day of the event and the days prior to and following the event day.
CAR [0 +1]	The abnormal return for the day of the event and the following day
CARO	Abnormal return for the day of the event
CEO	Chief executive officer
CG	Corporate Governance
СРР	Capital Purchase Program
DPP	Democratic Progressive Party
GCC	Gulf Cooperation Council
GDP	Gross domestic product
GLS	Generalized least squares
IFC	International Finance Corporation
IPO	Initial public offering
IPO	Initial public offering
M & A	Merger and Acquisition
MB	Market-to-Book ratio
MC_GDP	The country's market capitalisation deflated by GDP
NI	Firms' profitability
OECD	Organisation for Economic Co-operation and Development
OLS	Ordinary least squares
РМС	Political money contributions
R	Return
ROA	Return on assets
ROE	Returned-on equity
TARP	Troubled Asset Relief Program
UAE	United Arab Emirates
UNSC	United Nations Security Council

## Chapter 1: Introduction

#### 1.1 Background and research questions

There is a growing body of literature that recognises the importance of politicians' presence on firms' boards of directors as well as the implication of this presence for firms' performance. Politicians are considered important social elements who have greater power than other elements in a firm's environment (Pfeffer, 2010). They have the power to alter the systems and relationships that link all the elements within the environment. Therefore, firms aim to form ties with politicians in order to benefit from their authority and influence, which may help a firm harness other elements in the environment that may serve its needs, secure resources, and obtain a more preferential position than its competitors (Pfeffer, 2010). This role reinforces Resource Dependence Theory (RDT), which states that boards of directors are not only responsible for governing firms but also provide firms with networks, enhance their relationships with the surrounding environment, secure resources for them, and work to establish more significant relationships with the government (Pfeffer and Salancik, 1978; Pfeffer, 2010). According to the RDT, firms are open systems that may be directly and indirectly affected by external forces.

Previous studies have acknowledged the impact of companies' ties with politicians and have found a mixture of negative and positive effects, which have thus far failed to answer the question about the impact of a firm's political connection; this question remains unanswered and open to researchers in this field. For instance, several studies found that the firm's political connection leads to an adverse effect on the firm's business activities. For example, Bertrand et al. (2007) conducted a study in France to test the influence of politicians on firms' performance. The study found a negative impact; it also found that political push connects the firms, increases

employment rates, and builds factories during election years. The results additionally showed that politicians tended to push the connected firms to direct their operational efforts towards high political competition areas. Moreover, the study found that the politically connected firms paid their employees well and witnessed lower profitability compared to the unconnected firms, indicating that politicians used those firms to serve their political desires and electoral interests for the purpose of gaining votes. In terms of the quality of accounting information, Chaney et al. (2011) found that the companies with political connections endured a poorer quality of accounting information compared to the unconnected firms, as the protection provided by the politicians enabled them to neither pay close attention to the quality of their accounting information nor spend enough time and effort on this area. Evidence of politicians' protection is that, in normal situations, firms that provide poor quality of accounting information would suffer from high debt costs and limited access to credit; however, the current study found that, although the politically connected firms provide poor quality of accounting information, they do not incur higher debt costs, which demonstrates that political connection provides firms with protection against the negative consequences associated with providing poor quality of accounting information (Chaney et al., 2011). In addition, Abdul Wahab et al.'s (2015) study demonstrated that the auditors' independence from politically connected firms was weak; it also found that the politically connected companies paid higher fees for nonaudit services than the non-connected companies. In addition, the politically connected firms created weaker relationships between the audit and non-audit fees, suggesting that the auditors' independence was weak and that the politicians influenced the auditors' decisions.

In the other hand, other studies found positive effects of firms' political connections; previous research has found that such a relationship improves the profitability of connected firms. For instance, in Korea, Shin et al. (2018) found that Korean chaebol (politically connected firms) had a higher level of profitability and less risk than their counterparts, which was mainly due to the protection provided by the political connection against risk, litigation, rivals, and government investigations. Furthermore, it was determined that in Pakistan political ties provided firms with preferential treatment by obtaining lower debt costs and greater access to the credit market, even though they had higher default rates (Mian and Khwaja, 2004). Adhikari et al. (2006) found that political ties for firms contributed towards lower tax rates than the rates of their counterparts in Malaysia. Gounopoulos et al. (2017) who used an assembled Initial public offering (IPO) data to investigate the effect of political money contributions (PMC) on IPOs in the US found that the firms' PMC reflected positively on the IPO day. Furthermore, the study found that in the aftermarket period, shares of firms that used political money contributions witnessed lower volatility than the non-PMC counterparts, which indicates that the issuer's political agenda does not stop at the IPO stage but rather reaches the stock market participants as well (Gounopoulos et al., 2017).

The current thesis seeks to increase the understanding of the relationship between politicians and firms and the impact of this relation on firms' performance; it does this by conducting its research in a monarchical context. This thesis comprises three studies on politically connected firms in the context of the Gulf Cooperation Council (GCC). The first study (Chapter 2) evaluates firms' political connections and their effects on the firm performance hypothesis, which argues that politically connected firms have higher levels of profitability than other firms and stresses that in

a monarchical context, political influence originates from the royal family connection rather than a connection with non-royal politicians. The second study (Chapter 3) investigates whether firms' political connections affect the capital structure hypothesis. This hypothesis indicates that politicians may influence the level of a firm's leverage in two different ways: First, it does this by facilitating the firm's greater access to credit and higher levels of leverage; this is consistent with the Resource Dependence Theory (RDT), which predicts that board members will provide firms with access to finance. Second, it does this by appreciating the national culture of the context in which politicians work and by obtaining lower levels of debt, mainly because the societies in this study context are not in favour of debt. Chapter 3 also investigates whether or not a firm's religiosity affects its capital structure. The study tests the hypothesis that Islamic firms maintain lower levels of leverage than non-Islamic firms; this is mainly because Islam discourages incurring debt. It is worth noting that this is the first study to investigate this hypothesis. Finally, study three (Chapter 4) is the first work in the field to test the effects of political connections during political crises in several counties. The GCC political crisis of June 2017 created an opportunity to investigate the market reaction toward politically connected firms during the event. The study predicts that politically connected firms undergo more negative market reactions than non-connected firms, as the political crisis puts firms' political patronage at risk; this risk manifests itself as the threat of stopping resources obtained by the political patronage of the connected firms.

#### 1.2 Motivation for the research

This study was motivated by several factors. First, researchers have found that the presence of politicians on a firms' board of directors affects firms' performance, as politicians are considered to be key elements in the business environment, and their placement on the board of directors may act as a conduit for a firm to obtain significant power, including preferential treatment compared to its competitors. Politicians' presence on the board may also help firms to overcome bureaucratic difficulties and governmental investigations (Faccio, 2006; Hillman et al., 2009). However, the effects of firms' political connections are mixed and inconclusive, leading to increased interest in understanding this relationship. For instance, prior studies found that firms' political connections granted them easy access to resources for financing and operating activities (Faccio, 2010; Faccio, 2006; Fisman, 2001; Xu and Zhou, 2008; Goldman et al., 2008). Other studies have shown that political connections could increase the risk of linking firms' resources to political goals (Bertrand et al., 2007; Jackowicz et al., 2014). These findings provide an incentive to further examine this relationship and its effects so as to increase the understanding of firms' political connections.

Second, the study is motivated by its examination context, which is the GCC region. Business in the GCC is characterised by considering investment in relationships and building connections as more important than the core of the business (Janahi and Weir, 2005); this implies that social networking is the most important factor for the success of a business. Thus, this study expects the business environment in the GCC to clearly indicate the outcomes of firms' political connections. Moreover, royal families rule all the GCC countries; sustaining the stability of their regimes, strengthening the legitimacy of their rule and maintaining

the loyalty and support of their society (Khalaf and Luciani, 2006). In the GCC, each regime's autonomy allows the ruling family to enjoy enormous power to control public policies and political commitment (Khalaf and Luciani, 2006). Royal families actively rule their countries, appointing ministers and limiting parliamentary authority (Yom and Gause III, 2012). Thus, the great and steady power that royal families in the GCC hold is expected to reinforce the view that royal family members, as opposed to non-royal politicians, have the ability to secure vital resources for connected firms. Therefore, using the GCC as a study context is expected to clearly illustrate that firms would like to be connected with the power holders in their countries – royal family members – which prior studies have not recognised.

Third, previous researchers have regarded politicians as a way to ensure access to resources and to overcome the environment of uncertainty, whereas few studies have examined when politicians' power may come under risk, investigating the impact of this on politically connected firms. These considerations have motivated the present researcher to investigate the impact of firms' political connections during periods of political crisis on stock market performance. Precisely, the study takes the GCC political crisis that occurred in June 2017 as an opportunity to examine market reactions toward politically connected firms during a political crisis.

Fourth, the effect of religion on capital structure has seldom been examined, except for in one study (Baxamusa and Jalal, 2014), which focused on firms located in Protestant- and Catholic-majority countries such as the United States. The limited attention on the effect of firms' religiosity on their capital structure has also motivated this study.

#### 1.3 Research design

This research is based on an empirical investigation that uses econometrics techniques to estimate the effect of political connections on firms' performance, capital structure, market reaction during political crises as well as the effect of their religiosity on their capital structure. The first essay collects data on the non-financial firms, listed in the GCC market from 2010 to 2015. I started the sampling period in 2010 to avoid the effects of the financial crisis on the GCC markets. Regression analysis was applied in the first essay to test the expected higher returns delivered by the firms' political connections. Similarly, the second essay collects data on the non-financial firms that are listed in the GCC market from 2010 to 2015. Regression analysis was applied in the second essay to investigate the effect of the firms' political connections and religiosity on their capital structure. The applied regression model in the first and second essays differentiates between the firms' political connections to the royal family and the firms with non-royal politicians in an aim to detecting any differences between the two types of connection.

The third essay uses financial market data to perform an event study based on the "market model", which focuses on the political crisis of June 2017 in the GCC region. The strength of this methodology lies on the fact that, given the existence of rationality in the marketplace, the financial markets will immediately reflect the effects of any security-related event (MacKinlay, 1997). The essay makes use of all the available data of companies that were variously listed on the GCC stock exchanges during the event.

Information on politically connected directors was carefully selected from the following three sources: (a) the companies' annual reports, (b) the parliament or the consultation council website for each country except Qatar, and (c) *Who's Who in the* 

*Gulf 2015–2016*. Al-Mashora and Al-Raya's list for Islamic financial consultancy was used to identify the Islamic-listed stocks in these stock markets.

#### 1.4 Key findings

The first essay aimed to answer the questions about the effect of firms' political connections on their performance in a monarchical context. Interestingly, the study found a significant difference between the impact of having connections with royal family members and non-royal politicians. Connections with non-royal politicians did not have a statistically significant impact on the performance of the connected firms; however, connections with the royal family had a statistically significant positive effect for firms. Thus, this study presents new evidence that the power holder who can influence the firm's' performance is dependent on the ruling system type. In previous studies that have been conducted within republican systems, politicians from parliament and ministers had power and influence over the performance of companies associated with them. In contrast, this study, which took place in a monarchical context, shows that the royal family members are the power holders and are able to influence companies' performance.

The second study aimed to answer questions about the effect of firms' political connections on their capital structure. Similar to the first study, the results showed that non-royal politicians did not have a statistically significant impact on firms' capital structure. However, the firms connected with royal families illustrated lower levels of leverage in contrast to prior studies' results; this can be explained by the royal families reflecting the culture of the study context, which is not in favour of debt. Furthermore, the second study found that Islamic firms maintained lower levels of leverage than non-Islamic firms, which may be further explained by the fact that Islam discourages obtaining loans.

The third study investigated the effect of political crises between countries on politically connected firms. On the one hand, it supported the findings of the first and second studies, as it demonstrated that market reactions did not provide a statistically significant result for the firms connected with non-royal politicians; this indicates that the investors did not appreciate the value of non-royal politicians' presence on the firms' boards of directors. On the other hand, it found that the firms connected with royal families showed statistically significant negative reactions in their stock market performance during the political crises. Additionally, it found that the degree of impact was associated with the extent of these countries' involvement in political crises, which pose a threat to royal families' power. These results indicate that investors and traders do indeed value firms' connections with royal family members, as this connection provides the connected firm with protection and vital resources.

This thesis also offers fresh insights into the extent to which firms' religiosity affects their capital structure. To the best of the researcher's knowledge, this is the first study to test the effect of firms' religiosity on their capital structure. This study found that the Islamic firms maintained lower levels of leverage than the nonreligious companies, which is explained by Islam's discouragement of obtaining loans.

#### 1.5 Main contributions

This thesis fills the gap in the literature on firms' political connections. It contributes by redefining the term 'politically connected firm' by considering the ruling systems in the study context. It shows that politicians in parliaments or minister's cabinet impact firms that have ties with them in republican ruling systems - this is not the case in monarchical ruling systems, as these politicians have limited power and are not able to affect the business activities and performance of the firms they are connected to. In addition, the study shows that the power holders who influence the business activities for firms in monarchical context are royal family members. This contributes to the political connection literature by arguing that, in monarchical systems, firms gain more benefits when they are connected with members of the royal family than with the minister's cabinet or members of parliament (MPs). Furthermore, this study is the first to investigate the impact of political crises on politically connected firms. The study takes a step forward in the political connection literature by analysing stock market reactions toward politically connected firms during political crises between countries. Moreover, this study contributes to the RDT by applying it in monarchical context during political crises, which is expected to give the theory a new application. Finally, this study fills the gap in the current literature on the impact of firms' religiosity on their capital structure, which is considered as an important issue mainly because of a growing academic interest in this field, particularly regarding Islamic firms.

### 1.6 Outline of the thesis

The structure of the thesis is as follows. Chapter 2 tests the effect of political connection on firms' profitability. It investigates whether ties with politicians would enhance or limit firms' performance. Chapter 3 investigates the effects of both political connections and religiosity on firms' capital structure. Chapter 4 examines the market reaction towards politically connected firms during political crises. Chapter 5 summarises the thesis and offers recommendations for future research.

## Chapter 2: The effects of political connections on firms' performance in the Gulf Cooperation Council countries

### 1 Introduction

The incentives and effects of firms' political connections have captured the attention of economists, researchers, and the public in recent years. Specifically, we witness that more and more politicians have "turned into" business leaders and vice versa1. Arguably, the distinguishing line between political/business networks has increasingly become blurry. Several studies have shown that firms involved in lobbying and establishing political connections gain easy access to resources for financing and operating activities (Faccio, 2010; Faccio, 2006; Fisman, 2001; Xu and Zhou, 2008; Goldman et al., 2008). Other studies have shown that political connection could increase the risk of linking firm resources to political goals (Bertrand et al., 2007; Jackowicz et al., 2014). To date, the findings on the effect of political connection on firm performance have been mixed and inconclusive. Furthermore, the majority of the previous studies have analysed republican systems and very few have studied monarchies. However, these studies have not analysed the role of the royal family members in depth but have rather focused on the roles of ministers and MPs.

Considering the gap in the existing literature on firms' political connections, this paper aims to investigate the effects of political connections on firms' performance in the monarchy context. It aims to analyse the different channels through which firms

<sup>&</sup>lt;sup>1</sup> For example, in the UK, the former prime minister, Tony Blair, was appointed senior JP Morgan advisor in 2008 after leaving Downing Street. Similarly, David Cameron joined First Data's International Advisory Board in 2017. Former deputy prime minister, Sir Nick Clegg, joined Facebook in 2018 as the Head of Global Affairs and Communications. In the USA, the current president, Donald Trump, is (or was) a powerful business leader. In Australia, the former prime minister, Malcolm Turnbull, was an influential banker and venture capitalist.

may establish political connection, for example by having a royal family member or non-royal family politicians on the board of directors.

This paper focuses on the GCC during the period of 2010–2015. The GCC has been chosen because it provides an interesting context for testing the effect of firms' political connection on performance. In the GCC, all the countries have monarchical systems that wield near-absolute power (Yom and Gause III, 2012). I started the sampling period in 2010 to avoid the effects of the financial crisis in the GCC markets. I used the available data on non-financial firms during the period. Information on politically connected directors was collected from three sources: (a) companies' annual reports; (b) the parliament or consultation council website of each country except for Qatar, which does not have an official webpage; and (c) Who's Who in the Gulf 2015-2016, issued by Asia Pacific Infoserv, which includes biographies of the most influential men and women in the GCC. The results indicated that being connected with the royal family reflected positively on the performance and profitability of firms, while being connected with the non-royal family politicians showed no statistically significant effect on firms' performance and profitability. These findings support the view that, in a monarchic system, the power source that would secure important resources and provide access to resources for operating activities is the royal family.

This research relies on the RDT to explain the motivations of the GCC firms for constructing a connection with politicians. According to the RDT, board members act as channels for their firms' access to important external resources, such as political connections, information, skills, legitimacy, and know-how for dealing with government bureaucracies (Pfeffer and Salancik, 1978; Boyd, 1990; Hillman and Dalziel, 2003; Goldman et al., 2008). The current study contributes to the RDT by applying the theory to monarchical systems that wield near-absolute power. The first contribution of this paper involves an analysis of the influence of political connections on monarchical systems. It extends the literature by showing that, in these systems, companies obtain more benefits when connected with members of the royal family rather than to the government or MPs. Prior business studies have not analysed political connections through the lens of the political system, despite the fact that the power held by politicians is influenced by the type of the political system (Puig, 2002). For instance, in parliamentary systems, governments gain their power from the support of the assembly, to which they are accountable, while in a presidential government, there is a division of power, where the president is independent from the assembly (Puig, 2002). In a monarchy, the government is led by a hereditary sovereign, and royal blood relatives control the important state positions and work to maintain the regime (Yom and Gause III, 2012).

The second contribution of this paper is that it draws on data from the GCC stock markets, which consist of six monarchical countries (Saudi Arabia, Kuwait, the United Arab Emirates (UAE), Qatar, Bahrain, and Oman). The stock markets of these countries have not been examined before to test the hypothesis that firms' political connections may affect their performance. This will contribute to a better understanding of the effect of political connections on firms' performance in a monarchy context. The theoretical contributions of this paper are expected to develop the RDT theory in the field of corporate governance (CG). The results demonstrate that, in a monarchy context, being connected with members of the royal family reflects positively in a firm's performance compared with an absence of connection or connection with non-royal politicians. Notably, this study is the first empirical investigation to find that the political context (monarchy context) does ultimately influence firm's political connection outcome. Moreover, this study offers insights to

regulators to understand how the presence of royal family members on boards of directors affects firm performance and profitability. The results may also be helpful to investors and financial analysts, mainly because they stress the importance of board composition when evaluating firms' future performance.

The remainder of the paper proceeds as follows. Section 2 provides a review of the literature related to the topic of firms' political connections. This is followed by Section 3, which illustrates the main theoretical framework used in this study. Section 4 develops the hypotheses tested in the study. The institutional setting of the context is illustrated in Section 5, while Section 6 illustrates the methodology employed for this study, including the sample, regressions models, and variables. The main findings of the study are reported and discussed in Section 7. Section 8 presents the conclusions, including a discussion of the main implications of the findings, the limitation of the study, and the opportunities for future research.

#### 2 Literature review

Researchers investigating the effect of political connections on firms have examined different issues. The first group of study has investigated government bailouts and the preferential allocation of government funds. The presence of politicians on firms' boards of directors is considered a proxy for firms' political connections (Bona-Sánchez et al., 2014). These studies have suggested that government is more likely to invest capitals in politically connected firms than otherwise (Duchin and Sosyura, 2012). An empirical study conducted by Duchin and Sosyura (2012) investigated the effects of firms' political connection and their eligibility to participate in the Capital Purchase Program (CPP)—the first and largest Troubled Asset Relief Program (TARP) initiative in the United States. After controlling for the financial and fundamental factors, they found a positive

association between the firms' political connections and the likelihood of application approval. Moreover, the study illustrated that the efficiency of government investment was reduced by political connections, benefitting connected firms and politicians at the public's expense (Duchin and Sosyura, 2012). Similarly, Faccio et al. (2006) conducted a cross-country study to investigate the relationship between firms' political connections and the likelihood of receiving government bailouts. After controlling for firm effects, they found that politically connected firms were significantly more likely to receive government bailouts than non-politically connected firms. Furthermore, the financial assistance provided by the International Monetary Fund (IMF) and World Bank are more likely to be used by the receiving countries to assist companies with political connection (Faccio et al., 2006).

The second issue concerning the effect of political connection that has attracted researchers' attention is its impact on facilitating firms' access to loans and reducing their costs. Mian and Khwaja (2004) examined political connections and loans in Pakistan, finding that politically connected firms enjoy preferential treatment; for example, they received 45% larger loans, even though they had a 50% higher default rates on these loans. This preferential treatment was mainly found in government banks, while private banks did not show such a preference (Mian and Khwaja, 2004). The study also found that the political power of the individuals linked with firms is important, mainly because more powerful politicians—determined by the number of votes obtained in elections as a proxy—gain greater preferential access to loans from government banks (Mian and Khwaja, 2004). Similarly, Li et al. (2008) examined the effects of political connections on access to the credit market by private entrepreneurs in China. They found that there is a significant positive relationship

banks (Li et al., 2008). Furthermore, Houston et al. (2014) conducted a study in the United States to examine the political connections of firms and their effects on access to loans in a country with an efficient legal system. The study showed that politically connected firms enjoy a significantly lower cost of loans than non-politically connected firms. This result was more pronounced for firms with stronger political connections (Houston et al., 2014).

The third issue about firms' political connection concerns its influence on firm value. Goldman et al. (2008) studied the effect of political connection on firm value in the United States. The study considered two main events, namely the 2000 presidential election and the appointment of politically connected directors to the boards of directors in the study sample. It showed that the Republican-connected firms' portfolios exhibited a positive, significant cumulative abnormal return (CAR) following the election of Republican candidate George W. Bush. In contrast, the Democrat-connected firms' portfolios showed a negative CAR following the election (Goldman et al., 2008). Moreover, the results illustrated that the companies witnessed a positive and statistically significant abnormal stock return after the appointment of a politically connected board member was announced (Goldman et al., 2008). In addition, Ang et al. (2013) identified Singapore as an interesting setting for investigating the effect of political connection where corruption is deemed absent due to the presence of high-quality institutions. By examining the industry-adjusted Tobin's Q and excess returns of the companies in the study sample, the results showed that politically connected firms operating in a highly regulated environment enjoy higher firm valuation than non-politically connected firms (Ang et al., 2013).

The fourth issue about the effect of firms' political connection is auditing. Studies in this area have concentrated on whether auditors' opinions are affected by

politicians sitting on the companies' boards of directors. Previous studies have claimed that the credibility of companies' financial statements does not rely solely on economic factors, but that it is also affected by political and institutional elements (Ball et al., 2003). For instance, the local governments in China tend to allocate the businesses they control to their preferred local auditors. In addition, they provide administrative support to those preferred local auditors via either government agencies or the public utilities under their control (Chan et al., 2006). This motivates local auditors to establish a good relationship with the local governments and produce audit reports that meet their desires, which implies a reduction in financial reporting quality (Chan et al., 2006). In addition, a study conducted by Chaney et al. (2011) showed that the quality of financial statements was systematically poorer for the politically connected firms than they were for the non-politically connected firms. This could be because the auditors of the politically connected firms did not enjoy the same level of independence that auditors of the non-politically connected firms did. Abdul Wahab et al. (2015) conducted a study in Malaysia to investigate auditor independence and political connections by examining whether political connections restrained the relationship between audit and non-audit fees. They found that the politically connected firms allocated a significantly higher level of non-audit fees than the non -politically connected firms, thereby impairing auditor independence in one way or another (Abdul Wahab et al., 2015).

The fifth issue concerning political connection is its effect on firm performance. Prior studies have acknowledged the impact of companies' ties with politicians and have found a mixture of negative and positive effects of this connection (Wu et al., 2012). For instance, Li et al. (2008) conducted a study to investigate the role of private firms' ties with the ruling Communist Party in China.

They found that political ties had a positive effect on firm performance, which was facilitated by the weak institutional environment (Li et al., 2008). Furthermore, Wu et al. (2012) conducted a study using a sample of Chinese listed firms for the period from 1999 to 2007. These researchers found that politically connected private firms outperformed those without political connection (Wu et al., 2012). Moreover, they found that taxation benefits represented an important way of improving firm performance through political connection. In addition, Su and Fung (2013) conducted a study in China to examine the relationship between political connection and firm performance using Chinese firm data from 2004 to 2008. The study illustrated a positive effect of political connection on firm performance (Su and Fung, 2013), demonstrating the channels through which the positive influence of political connection was recognised, which included higher cash holdings, greater long-term debts, lower debt costs, and higher and lower sales costs; these all led to enhancing the firms' performance (Su and Fung, 2013).

Turning now to discuss the negative consequences of firms' political connection for their performance. Bertrand et al. (2007) found that politically connected firms in France reported lower profitability than those without any connection. The study also found that politically connected firms paid higher wages to employees and built more factories during election years. Furthermore, the study found that the politicians prompted the connected firms to concentrate their operating activities on the high political competition areas, which implies that politicians used these firms to serve their political desires and electoral interests for the purpose of gaining votes. In addition, Fan et al. (2007) conducted an empirical study on newly partially privatised firms in China to investigate the effect of firms' political connection through the politically connected chief executive officer (CEO). The study

found that the firms with politically connected CEOs tended to underperform the firms without political connection by 18%, based on three-year post-IPO stock returns. Further, the politically connected firms witnessed lower three-year post-IPO earnings growth, sales growth, and change in returns on sales. Moreover, the politically connected firms underperformed their non-connected counterparts on the first-day trading stock return. Furthermore, Jackowicz et al. (2014) conducted an empirical study on the effect of firms' political connection on their performance in Polish non-financial companies for the period 2001–2011. The study found that the politically connected firms underperformed those with no connection in profitability, measured by the level of income from sales. In addition, the authors found that as the firms succeeded in securing multiple political connections, they tended to experience more negative impact on their profitability.

The existing literature on firms' political connection has ignored the absolute monarchy context, where royal blood relatives control the important state positions and work to keep the regime in power (Yom and Gause III, 2012). Most of the existing studies have focused mainly on republican systems. Moreover, previous studies have not been able to detect the significant differences in power between royal family members and other politicians. In addition, there is considerable uncertainty about the relationship between political connection and firm performance, mainly because of mixed results. The aim of this study is to provide a better understanding of the effect of firms' political connection on its performance in the monarchy context. In addition, this study intends to explore the differences in the influence of royal family connections compared to other politicians. Moreover, this study tries to gain a further understanding of the effect of political connection on firm performance.

#### 3 Theoretical framework

#### 3.1 Relationship between the organisation and its environment

Organisations do not work in isolation from their environment. Rather, they work within them and interact with them; moreover, the social context is the most important part of the organisational environment (Pfeffer and Salancik, 2003). In the organisational social context, there are many elements that contribute to a network of social relationships and interdependence (Granovetter, 1985). Organisations need capital, workers, customers, suppliers, and other resources to operate successfully. Such resources are obtained from the environment in which the organisations operate, leading to the need for firms to be able to interact effectively with their environment to survive and, hopefully, succeed. Organisational activity has a dynamic nature that seeks to adapt to the external environment (Hollingshead, 1950). There is no organisation that is fully self-contained; organisations need to be proactive to secure their resources. Therefore, they work to raise their level of power in the environment and thus reduce the risks of dependence on others (Hillman et al., 2009).

An organisation is a small social system that works to achieve its defined goal, which ultimately contributes to a larger social system that we call "society" (Parsons, 1956). Organisational legitimacy has been defined by researchers as the acceptance of the organisation by its environment and stresses the importance of the organisation to survive and succeed (Kostova and Zaheer, 1999). Without environmental acceptance, an organisation will not be able to use any resources it needs in the environment. The resources that an organisation uses can be employed in alternative ways by others—organisation's legitimacy is the key that allows it to use that resource (Parsons, 1956). This leads to the establishment of an interdependent relationship between the organisation and its environment, represented by different

actors located in them. Interdependence occurs when an organisation does not fully control the setting that enables it to perform successfully; it is not a static but rather a dynamic interdependent relationship (Pfeffer and Salancik, 2003). For instance, the demand for a specific resource changes according to its quantity, the number of the environmental actors that require it, and the importance of that resource for different units in the environment.

The challenge behind interdependence is that it creates uncertainty for organisations, and uncertainty implies risk. The ability for the organisation to remain in business and reach its aims is threatened by uncertainty, which could also affects its structure (O'Reilly and Pondy, 1979). The significance of dependence risk for an organisation relates to its level of dependence on the other actors in the environment. Emerson's (1962) theory of power-dependence relations was developed in an effort to explain the reasons for an actor to possess power or authority over other actors in the environment. In Emerson's (1962) exchange framework, the dependence level is determined based on resource criticality and the availability of alternative providers of that resource. A recognisable threat for the organisation is that the actor who controls a resource will mainly serve the interests of other actors who deal with it (Perrow, 1972). Organisations need to acknowledge their environment and, further, they need to respond to their environment's associated uncertainty risks. Organisations will work with other units in the environment to negotiate and apply arrangements to lower their uncertainty risks (Pfeffer and Salancik, 2003). However, this strategy may not always work, mainly because of the wide differences in interest with other units. Organisations understand the importance of forging ties with actors who have good connection within the environment and are able to act as a conduit for the organisation to secure vital resources. Organisations that bond with powerful

members of their environment are capable of gaining critical resources from the environment (Provan, 1980). For instance, firms that operate in highly regulated industries tend to need more outsider board members with precise and relevant involvement (Pfeffer and Salancik, 1978). In short, the level of firms' financial access is expected to be higher in firms with representatives of financial institutions on their boards of directors (Mizruchi and Stearns, 1994). In addition, firms rely on former government officials as directors, as they are able to provide valuable advice concerning public policy, provide connections with the existing government officials, and influence political opinions (Hillman, 2005; Lester et al., 2008).

Politicians are considered important influential actors in the firm environment, mainly because they are able to secure vital resources for firms. This would motivate firms to become involved with politicians who own high social power to form a more secure environment (Pfeffer and Salancik, 2003). In this way, the organisation acknowledges that neither laws nor social values are absolute; they can change through a high level of social power, proportional to the focal organisational needs (Pfeffer and Salancik, 2003).

#### 3.2 Politicians as social actors

Politicians hold high social power in organisations' environments, which allows them to influence organisational performance. The level of political power that influences an organisation's environment depends on its context (Pfeffer, 2010). It is common that, in the context of high corruption and low democracy, politicians have substantial power, which encourages organisations in such contexts to work towards acquiring such a unique resource—a political resource, which allows it to act and communicate with power in its environment (Faccio, 2010).

Compared with its economic power, the organisation's political power requires less time to be developed (Mitchell and Hayes, 1984). While political power may not be an organisation's ultimate desire, it is a tool that can support firms' economic activity (Boddewyn and Brewer, 1994).

An organisation's political participation is not usually random but rather follows an entrance strategy. The strategy starts with determining the types of intended politician, such as the MPs, the royal family, or ministers, continues with specifying the appropriate political participation level, and culminates in working out the details of the strategy (Hillman and Hitt, 1999). The political entrance is context relevant and varies from country to country; a specific level of democracy, for instance, would require its specific strategy.

The introduction of a politician into an organisation can happen in different ways. The most popular approach involves offering a seat on the organisation's board of directors. According to the RDT, one of the main roles of firms' boards of directors is to facilitate access to new resources (Pfeffer and Salancik, 1978). Under the RDT, board members provide their firms with important resources, such as political connections, information, skills, legitimacy, and know-how for dealing with bureaucracies (Pfeffer and Salancik, 1978; Boyd, 1990; Hillman and Dalziel, 2003; Goldman et al., 2008). According to the RDT, firms are open systems that can be directly and indirectly affected by external forces. A firm's response to these forces depends on the external players and degree of environmental uncertainty. In cases of environmental uncertainty, firms work to lower the level of uncertainty by maintaining power over vital resources. For instance, a firm whose operations rely on government contracts would like to have someone close to the government on its board of directors to ensure the continuous flow of government contracts. In other

words, it is the board of directors' role to manage environmental uncertainty and lower its associated costs (Pfeffer and Salancik, 1978).

The RDT has become a key theory in strategic management and organisational theory (Hillman et al., 2009). It has been applied in studies relating to the composition of boards of directors. The studies in this area have concentrated on the board size and how it will provide resources to the firm. The board size is expected to reflect the firm's environmental requirements and form a response to the external environment conditions (Pfeffer, 1972; Sanders and Carpenter, 1998). The size of the board helps the company to build important relationships with the external environment, which will enable it to secure important resources (Goodstein et al., 1994). This has been supported by an empirical study by Dalton et al. (1999) who found that firms' financial performance increases as the board size increases. The study stated that these relationships are consistent for market-based and accountingbased firm performance measures. Moreover, firms' board gender diversity, measured by the percentage of female board members on firms' boards of directors, has been found to help firms fulfil stakeholders' requests for improved public reporting about climate change-related risks by providing voluntary climate change disclosure (Ben-Amar et al., 2017). Furthermore, the RDT theorists note that firms can undertake political moves to reduce uncertainty from these environmental contingencies. Through political ties, firms try to affect their environment to support their interests (Pfeffer and Salancik, 1978). The rationale behind firms' political moves is that any system can regulate resources in a manner that influences over resources; thus, firms can influence regulators, giving them power over the regulated resources (Pfeffer and Salancik, 1978).

The probability of a firm developing political connections relies on the environment in which it works. Several variables facilitate connections, while others act as barriers. For instance, a seminal work by Faccio (2006) found that political connectedness is common in countries where there is a high level of corruption and restrictions on foreign investment, while it is less common where there are restrictions on board membership or ownership by MPs, high disclosure requirements, or an effective legal system. At the firm level, politically connected firms have several common characteristics. For instance, the level of owner concentration in politically connected firms tends to be high, which is explained via three main reasons. First, there is a high level of homogeneity among shareholders' interests, which facilitates the establishment of political connections. Second, the benefits of political connections are not diminished by a wide range of owners. Finally, ownership concentration reduces the demand for reporting information about political rents, which is preferred by both the principal owner and politicians, who both have common interests in covering the trade of favours and encouraging politicians to engage in these relationships (Chen et al., 2011). Moreover, politically connected firms tend to seek local financing instead of going global, due to inexpensive financing from state-owned banks (Leuz and Oberholzer-Gee, 2006). Furthermore, when firms go global, they must adapt to foreign regulations and submit to the scrutiny of global financial analysts, which may make it difficult to benefit from political connections (Baker et al., 2002; Leuz and Oberholzer-Gee, 2006).

#### 4 Hypothesis development

The RDT recognises the influence of external environmental players on firms' behaviour. Although constrained by their context, firms' board members are able to decrease an organisation's environmental uncertainty and dependence. According to the RDT, one of the leading roles of firms' boards of directors is to facilitate access to new resources (Pfeffer and Salancik, 1978). Under the RDT, board members provide their firms with important resources, such as political connections, information, skills, legitimacy and know-how for dealing with bureaucracies (Pfeffer and Salancik, 1978; Boyd, 1990; Hillman and Dalziel, 2003; Goldman et al., 2008). Firms can secure vital resources by having politicians on their boards of directors.

Politicians have high social power in a firm's environment, allowing them to affect performance (Pfeffer, 2010). Political connections influence firms' operations through government contracts, lighter regulatory oversight, greater economic power and reduced transaction costs when dealing with government agencies (Faccio, 2006; Fisman, 2001; Chaney et al., 2011; Faccio, 2010; Qian et al., 2011; Goldman et al., 2008; Xu and Zhou, 2008; Blau et al., 2013). For instance, Li et al. (2008) investigated the effects of political connection in China and found that political ties had a positive effect on firms' performance, which was facilitated by the weak institutional environment. Furthermore, Su and Fung (2013) conducted a study in China and found a positive relationship between political connections and firm performance. They showed that firms with a political connection maintained higher cash liquidity than non-connected firms – liquidity they used to secure investment opportunities. On the sales side, they found that these firms sold more than nonconnected firms whilst having lower sales costs. Furthermore, they had preferential access to finance with lower financing costs (Su and Fung, 2013).

Other empirical studies have highlighted the negative impact of firms' political connections. It has been found that politicians can take advantage of the firms they have ties with to serve their own political interests. For instance, Bertrand et al. (2007) found that in France, political connection caused lower profitability compared to firms without connection. Moreover, politically connected firms pay higher wages to employees, build more factories during election years and prompt the connected firms to concentrate their operating activities on areas of high political competition, implying that politicians use their firm connections to serve their own political needs (Bertrand et al., 2007). Similarly, an empirical study conducted in China by Fan et al. (2007) found that politically connected newly partially privatised firms witnessed lower three-year post-IPO earnings growth, sales growth and change in returns on sales compared to firms without connections. They also found that politically connected firms underperformed firms without political connections by 18% based on three-year post-IPO stock returns. Another study found that politically connected firms in Poland underperformed non-connected firms in profitability, measured by income from sales (Jackowicz et al., 2014). The researchers found that multiple political connections within firms had a negative impact on their profitability.

The characteristics of the business environment in the GCC indicate that political connection would benefit firms' performance, mainly because the social network is recognised as a vital element to make a business successful in the GCC (Janahi and Weir, 2005). Moreover, the region's social structures emphasise the importance of kin and network as sources of social support and business prospects (Al Janahi and Weir, 2005), to which the dominant state bureaucracies in the business environment in the region can be added (Weir, 2011). This indicates that politicians

provide connected firms with relationships and nexus within their social networks. Further, politicians are expected to help connected firms to navigate the state bureaucracies through their skills in anticipating government actions. The pivotal source of these skills is knowledge of procedures or friendships with key decision makers (Agrawal and Knoeber, 2000). Based on these considerations, the following hypothesis was developed:

## *Hypothesis 1:* Politically connected firms will have higher profitability than non-politically connected firms.

The second hypothesis is related to the characteristics of political connections in the monarchical context. The royal family is considered to be an important element in the state administration in a monarchical system, representing the source of power; thus, it is expected that ties with the royal family will result in easy access to vital resources. For instance, in Morocco, which is considered as a constitutional monarchy, the king enjoys a constitutional bias in his favour. The political process in the country is described as weak, keeping ultimate authority and power in the hands of the king (Maghraoui, 2001). Moreover, in the Hashemite Kingdom of Jordan, another constitutional monarchy, the lower house of parliament is elected by popular vote, while the king appoints the upper house, which holds most of the real power (Helfont and Helfont, 2012). The king also prepares the lists of reforms needed for the country and then offers them to the prime minister for implementation (Helfont and Helfont, 2012). In GCC, The royal families rule all the region countries; sustaining the stability of their regimes, strengthening the legitimacy of their rule and maintaining the loyalty and support of their society (Khalaf and Luciani, 2006). Furthermore, in a monarchical system, the power is not limited to the king, as the royal family also enjoys power and influence. Thus, royal family members are keen
to handle leadership succession smoothly by passing the throne to a family heir to ensure that they will continue benefiting from the monarchical system and maintain their influence and power, which they acquired simply by being members of the ruling family (Magaloni, 2008). The stability and continuation of the system is reflected in the collective welfare of the royal family members. Even the presence of political parties and parliament does not limit the power of the royal family, as they remain the centre of power in their country (Magaloni, 2008). Thus, this study expect their power to access resources to be stable, high and long-lasting compared with non-royal politicians, whose power is limited to the time they are an MP or minister. Furthermore, the ruling families in the GCC monarchical regimes have enormous power to change or reverse public policies and political commitments (Khalaf and Luciani, 2006). This gives royal family members the ability to change laws according to firms' needs. In addition, the dynastic regimes in the GCC do not only reign but also rule: they appoint ministers, prepare major national and international policies and limit parliamentary authority (Yom and Gause III, 2012). This means that royal family members have more power and authority than other politicians. Based on these considerations, the following hypothesis was developed:

*Hypothesis 2: Firms with royal connections will have higher profitability than firms with non-royal political connections.* 

5 Institutional setting

#### 5.1 Political and economic overview

The GCC is a regional intergovernmental political and economic union that consists of Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and the UAE. These countries share the same language (Arabic) and have similar cultures. Oil and gas are the main sources of income and fiscal revenue for the GCC countries (IMF, 2013a). There are three constitutional monarchies (Bahrain, Kuwait, Qatar), two absolute monarchies (Oman, Saudi Arabia), and one federal monarchy (the UAE).

Data <sup>2</sup>	Bahrain	Kuwait	Oman	Qatar	Saudi Arabia	UAE
GDP (US \$ Millions) (2015)	30,417.6	114,118.3	61,521.2	185,397.6	653,219.2	345,483.2
Corruption Index	70	75	64	31	62	24
Unemployment (2015)	1.3%	2.8%	21.2%	0.2%	5.7%	4.8%
Sovereign Fund	\$11.1	\$592	\$6	\$256	\$673.9	\$1,066
Market Cap (billions) (2016)	15	71	22	156	376	223
Population (millions) (2013)	1.314	3.369	3.219	2.123	27.345	5.628

#### Table 1

The Al Khalifa family has ruled Bahrain since the 18<sup>th</sup> century, and the current president of the country is Amir Hamad bin Isa Al Khalifa, who has been in the position since 1999. In 2002, the country's constitution established Bahrain as a constitutional hereditary monarchy with the new title of "king" for the ruler. The constitution gives the king the authority to appoint the prime minister and council ministers (eGovernment, 2016). The legislative authority is divided into two houses. The first house is the Consultative Council, which has 40 members appointed by the king (eGovernment, 2016). The second house is the Chamber of Deputies, with 40 members elected by the citizens (eGovernment, 2016). However, both houses are granted limited powers (Passport, 2016a). Bahrain's economy relies on oil production, although transport, tourism, hotels, and services are also major economic sectors (IMF, 2014b).

Kuwait has been ruled by the Al-Sabah family since the 18<sup>th</sup> century. Economically, this country enjoys great wealth from oil. Although small in size (17,818 km<sup>2</sup>), it controls the world's sixth largest oil reserve (102 billion barrels),

<sup>&</sup>lt;sup>2</sup> Sources: Central Intelligence Agency, Transparency International, World Bank, Sovereign Wealth Fund, Bloomberg Terminal

which, at the current production rate, should last for almost 90 years. In addition, Kuwait was promoted to an emerging-market classification by index compiler FTSE Russell in late 2017. Politically, Kuwait's constitution, created in 1962, is the prime source of all laws in the country. According to the constitution, the Amir is the Head of the State and His person is safeguarded and inviolable; the Amir exercises his powers through his ministers (Kuwait, 1962). The National Assembly of Kuwait comprises 50 members, selected by a general direct election; no law can be promulgated except via ratification by the National Assembly and sanction by the Amir (Kuwait, 1962). However, the National Assembly's activity has been halted twice, once in 1974 and again in 1986, each time for 4 years (Kuwait, 2015).

Since 1744, the Albusaidi family has been ruling Oman (Mofa, 2016). The Sultanate of Oman is ruled by Sultan Qaboos, who overthrew his father in the coup of 1970 (Passport, 2016b). The Sultan is also the prime minister and appoints the cabinet members (Passport, 2016b). The country has a bicameral parliamentary system (Passport, 2016b). The Consultative Assembly has 84 elected members with only consultative tasks, and the Council of State has 59 appointed members with limited power (Passport, 2016b). Economically, Oman is among the world's top oil exporters, and its recent economic boom has been facilitated by the global rise in oil prices.

Since the mid-19<sup>th</sup> century, the Al Thani family has ruled Qatar (CIA, 2016b). In the late 1980s to early 1990s, the country's economy suffered because the then-Amir Khalifa bin Hamad Al Thani squandered the petroleum revenues (CIA, 2016). In 1995, his son, Hamad bin Khalifa Al Thani, overthrew his father in a coup (CIA, 2016b). Due in part to its immense wealth, the country encountered no difficulty in overcoming the turbulent 2010–2011 period in the Middle East (CIA, 2016b). Amir

Hamad peacefully transferred power to his son, the current Amir Tamim, in 2013 (CIA, 2016b). The country has a Consultative Assembly of a 45-member parliament—30 elected by voters and 15 appointed by the Amir—responsible for monitoring the government's performance (Passport, 2016c). Economically, Qatar is the largest exporter of liquefied natural gas in the world (IMF, 2014c). Over the past decade, the country has experienced an average growth rate of 14%, and its GDP per capita has reached \$100,000—the highest in the world. Qatar has become a significant global financial investor in recent years. For example, in preparation for the FIFA 2022 World Cup, the country has made significant investments in public projects.

The Kingdom of Saudi Arabia is a monarchy, governed by the Al Saud family, from which the country's name is derived. The family has ruled the country for three different periods: 1744–1818, 1824–1891, and 1932–present (Momra, 2016). The present king, Salman bin Abdul-Aziz, has ruled since 2015. The government's legitimacy is based on its interpretation of the Islamic law (the Sharia) and the 1992 Basic law (State, 2016). The religious group along with the royal family established a country with a strong religious-political orientation (Kechichian, 1986). The religious group is considered to be the main source of political pressure in the country (CIA, 2016a). The country witnessed its first election in 2005, which allowed only male voters to vote on a non-party basis, electing 50% of the members of the municipal councils (State, 2016). The country has been criticised for its poor human rights records. The inability to exercise a significant choice in government, limited freedom of expression, and gender-based discrimination are considered the main human rights issues in the country (State, 2015). Economically, Saudi Arabia is

considered one of the top economic performers in the G20 (IMF, 2013b). As the world's largest exporter of crude oil, it plays an important role in the oil market.

In December 1971, six emirates (Abu Dhabi, Dubai, Sharjah, Umm Al Quwain, Fujairah, and Ajman) announced the establishment of the federation that would eventually be named the United Arab Emirates (Government, 2016). A seventh emirate, Ras Al Khaimah, joined the federation in February 1972 (Government, 2016). The permanent constitution was approved by the rulers of the emirates in 1996 and named Abu Dhabi as the UAE's permanent capital; in addition, it formed the Federal Supreme Council with membership of the seven emirate rulers (Passport, 2016). Abu Dhabi enjoys a dominating political power concentration among the other six emirates, and it controls most of the UAE's economy and resources (Passport, 2016d). Moreover, the constitution established the Federal National Council, which consists of 40 members—20 appointed by the emirate rulers and 20 elected by indirect votes through local councils; however, it has no legislative powers (Passport, 2016d). Finally, the president of the UAE is elected by the Federal Supreme Council (Passport, 2016d). Economically, the macroeconomic outlook for the UAE is positive and its financial market performance is strong, reflecting the confidence of market participants (IMF, 2014a). Backed by tourism and a resounding real estate sector, the UAE is experiencing a stable economic growth, and its government continues to promote economic diversification in the country. The banking system is solid by virtue of its liquidity buffers, strong CG, and enhanced financial integrity framework (IMF, 2014a).

In the GCC, the power that MPs hold is considered to be limited. For instance, in Bahrain, Oman, Qatar, the KSA and the UAE, their parliaments are consultative assemblies and mainly function as advisory bodies. In contrast, Kuwait's National

Assembly has been halted twice, once in 1974 and again in 1986, each time for four years. Further, no law in Kuwait can be promulgated except via ratification by the National Assembly and sanction by the Amir. Thus, MPs' power in the GCC is limited, indicating that they are incapable of influencing politically associated firms' performance and success.

#### 5.2 Corporate Governance in the GCC

Corporate Governance (CG) is a system that determines a wide range of procedures and processes concerning the functioning and regulation of relationships between managers and shareholders. CG was first defined in 1992 in a report by Sir Adrian Cadbury as a "system by which companies are directed and controlled" (Cadbury, 1992, p.15). Most subsequent definitions of CG pay attention to the conceptions of "fairness" in firms' external environment, such as in the legal and regulatory systems, which are linked with the cultural beliefs evident in the firm context (Weir, 2011).

CG was launched in the GCC through cooperation between the Organisation for Economic Co-operation and Development (OECD), the International Finance Corporation (IFC), and the World Bank, leading to the establishment of the Institute for Corporate Governance—Hawkamah—in 2006. Hawkamah helped overcome the existing governance gap by developing and implementing well-integrated CG frameworks in the GCC countries.

Business in the GCC began by establishing relationships and investing in building connections prior to the core of the business (Janahi and Weir, 2005); this implies that in the GCC social network is the most important factor for the success of a business. Thus, the model of the business relationships is believed to be long

lasting; this is in line with the region's social structures, which stress the importance of kin and networks as sources of social support and business prospects (Al Janahi and Weir, 2005). The state bureaucracies dominate the business environment in the region (Weir, 2011), which is viewed as inefficient, negatively influencing investors and slow economic progress (Dobrescu et al., 2012; Frâncu, 2014). Furthermore, the GCC is recognised as encompassing highly networked societies, where trust and respect build social obligation (Weir, 2008). Decision making tends to be carried out at a high level of the organisational hierarchy, and the authoritarian management type is dominant (Weir, 2011). The board gender diversity is found weak in the GCC-listed companies. Further, the majority of board members are present on a single board (Amer and Davidson, 2008). Moreover, firms with concentrated forms of ownership are found to be very common in the region (Hawkamah, 2014). Similarly, company family-domination is very common in the region, with the strong family leader taking the highest position in the firm (Hawkamah, 2014). The large capital surpluses of the GCC countries support them to create state-owned enterprises (Hertog, 2012). Stateowned banks are highly represented in the financial industry of the region (Hawkamah, 2014).

# 6 Methodology

# 6.1 Sample

I initially collected data on all the listed companies in the GCC during the period of 2010–2015. The initial sample size was 661 firms with yearly observations; however, 90 firms were removed due to unavailable data, bankruptcy, or delisting from the stock market, reducing the sample to 571 firms. Then, I removed the financial industry firms, due to distinctive regulation and operating nature (Wang and Dou, 2015; Bai et al., 2010; Naser, 1998). This reduced the final sample to 346 firms.

I started the sampling period in 2010 to avoid the effects of the financial crisis on the GCC markets. Information on politically connected directors was manually collected from three sources: (a) the company's annual reports, (b) the parliament or consultation council website<sup>3</sup> of each country except for Qatar, which does not have an official webpage, and (c) *Who's Who in the Gulf 2015–2016*, issued by Asia Pacific Infoserv<sup>4</sup>, which includes biographies of the most influential men and women in the GCC (Tane, 2016) (see Table 2 for the source of each variable).

#### 6.2 Regressions models

As discussed while developing the hypotheses, the existence of political linkages in any board of directors is expected to deliver higher returns, especially in weak institutional environments and in those with high corruption, as in the present context. To test the first hypothesis, which predicts that politically connected companies will have higher profitability compared with non-politically connected firms, the study implements the following models, labelled Models 1 and 2. To test the second hypothesis, which predicts that royally connected companies will have a higher profitability compared with firms connected with non-royal politicians, the study implements Models 3 and 4 to estimate the effects of politicians on firm performance.

Model 1

$$ROE = \beta_0 + \beta_1 Politically connected firms_{it} + \beta_2 Age_{it} + \beta_3 Government_{it} + \beta_4 Size_{it} + \beta_5 Board_Size_{it} + B_6 Leverage_{it} + i. Country + i. Industry + i. year$$

<sup>&</sup>lt;sup>3</sup> Kuwait: <u>http://www.kna.kw/</u>,Saudi Arabia: <u>http://www.shura.gov.sa/</u>, Bahrain: <u>http://www.nuwab.gov.bh/</u>, United Arab Emarits: <u>http://www.almajles.gov.ae/</u>, Oman: <u>http://www.statecouncil.om/.</u>

<sup>&</sup>lt;sup>4</sup> <u>http://api-publishing.com/</u>

#### Model 2

$$ROA = \beta_0 + \beta_1 Politically connected firms_{it} + \beta_2 Age_{it} + \beta_3 Government_{it} + \beta_4 Size_{it} + \beta_5 Board_Size_{it} + B_6 Leverage_{it} + i. Country + i. Industry + i. year$$

Model 3

$$\begin{aligned} ROA &= \beta_0 + \beta_1 \text{Royal politically connected firms}_{it} \\ &+ \beta_2 \text{Non} - \text{Royal politically connected firms}_{it} + \beta_3 Age_{it} \\ &+ \beta_4 \text{ Government}_{it} + \beta_5 \text{ Size}_{it} + \beta_6 \text{ Board_Size}_{it} \\ &+ B_7 \text{ Leverage}_{it} + i. \text{ Country } + i. \text{ Industry } + i. \text{ year} \end{aligned}$$

# Model 4

$$\begin{aligned} ROE &= \beta_0 + \beta_1 \text{Royal politically connected firms}_{it} \\ &+ \beta_2 \text{Non} - \text{Royal politically connected firms}_{it} + \beta_3 Age_{it} \\ &+ \beta_4 \text{ Government}_{it} + \beta_5 \text{ Size}_{it} + \beta_6 \text{ Board_Size}_{it} \\ &+ B_7 \text{Leverage}_{it} + i. \text{ Country } + i. \text{ Industry } + i. \text{ year} \end{aligned}$$

# 6.3 Dependent variables

To test the effects of political connections on firm performance, I used both the returned-on equity (ROE), calculated as net income divided by shareholder's equity, and the return on assets (ROA), calculated as net income divided by total assets. ROE and ROA are used in empirical studies to represent a firm's accounting profitability (Lee and Park, 2009). ROE is used as an indication of the return on investment for the shareholder and the company's performance and profitability. It is also used by potential investors as a way to compare the performance of the company with that of other firms (Ellinger et al., 2002). ROA is used as an alternative way of evaluating firm financial performance, as it indicates the return for shareholders from the investment of firm capital (Ellinger et al., 2002).

# 6.4 Independent variables

The definition of politically connected firm is critical for this study. Consistent with Faccio (2006, 2010), firms are considered politically connected when at least one politician (e.g., an MP, minister, head of state, or a person closely related to a top official) sits on the board of directors. However, the definition of political connection, developed by Faccio, did not take into account the context of the monarchical systems in the form of royal families as key political actors (Magaloni, 2008). For this reason, this study also considers a firm to be politically connected when at least one member of the royal family sits on the board of directors.

The characteristics of political connections differ among politicians, thereby affecting their power and authority according to the context. Firms connected with royal family members are expected to gain greater access to resources compared with non-royal politicians. This is because in monarchical systems, the power is not exclusive to the king, mainly because the royal family also maintains power, influence, and access to the king. Therefore, I use two different political connection variables to analyse whether there is a difference in the performance of firms connected with the royal family from those that do not have such a connection. I consider firms to have a royal connection when at least one member of the royal family sits on the board of directors, and I consider firms to have non-royal political connection. The data for these variables are obtained from companies' annual reports, parliament or consultation council website, and *Who's Who in the Gulf 2015–2016*.

## 6.5 Control variables

I introduce several control variables into my analysis to control for industry, year, and firm characteristics. The performance of a firm is affected by its size (Chang and Wong, 2004). Large firms have scale economies and enhanced financial access, which can positively affect firm performance (Xu and Wang, 1999; Qi et al., 2000).

Following Bona-Sánchez et al. (2014), I controlled for firm size using the natural logarithm of the market value of the company equity at the end of the year. The data on firm size were obtained from Datastream. Since the study sample includes companies from six countries, all data on firm size have been converted to the US dollar currency using Datastream's "set currency" option. Previous studies found that financial leverage affected the cost of capital, which influences firms' profitability (Miller, 1977; Myers, 1984; Sheel, 1994; Hutchinson and Gul, 2004; Sun et al., 2002). To control for the leverage effect, I include "Leverage", which is the total debt in year t divided by total assets at the beginning of the year t, which were obtained from the Datastream database. It is argued that government ownership negatively affects performance, mainly because of the government's choice of social and political policy goals over profitability (Sun et al., 2002). To control for this, I include the Government variable, which represents the percentage of government ownership in the company obtained from the Bloomberg database. The listed firms in my sample operate in different industries, making them subject to different levels of competition and regulation; this leads to different opportunities to earn profits (Opper et al., 2002; Chang and Wong, 2004; Wong et al., 2004). Therefore, I include industry dummies, denoted by "Industry", to capture the industry-specific effect. Industry was measured with a set of dummy variables which is: Industry-utility which takes value of 1 if the company operate in the utility industry and 0 otherwise. Industry-Industrial which takes value of 1 if the company operate in the industrial industry and 0 otherwise. Industry-Transportation which takes value of 1 if the company operate in the transportation industry and 0 otherwise. Industry-others which takes value of 1 for the other non-financial companies and 0 otherwise. The "Board Size" variable is used to control for board cohesiveness and as a proxy for describing the governance structure,

which may influence firm performance (Barnhart and Rosenstein, 1998; Yermack, 1996). The Board Size variable is the natural logarithm of the total number of directors who sit on the board. The Age of a firm is included because it is argued that older firms are more experienced; therefore, they will have higher performance (Majumdar, 1997). The Age variable is the natural logarithm of the number of years, since the firm was founded. Table 2 summarises all the variables.

Table	2
-------	---

Variable	Definition	Source
Dependent Variables		
ROE	Net income divided by shareholder's equity	Datastream database
ROA	Net income divided by total assets	Datastream database
Independent Variables		
Politically connected firms	Equals 1 when at least one member of the royal family, member of parliament, minister, or head of state sits on the board of directors, and 0 otherwise	<ul> <li>1- Company's annual reports</li> <li>2- Parliament or consultation council website</li> <li>3- Who's Who in the Gulf 2015–2016</li> </ul>
Royal politically connected firms	Equals 1 when At least one member of the royal family sits on the board of directors, and 0 otherwise	<ul> <li>1- Company's annual reports</li> <li>2- Parliament or consultation council website</li> <li>3- Who's Who in the Gulf 2015–2016</li> </ul>
Non-royal politically connected firms	Equals 1 when no royal family member sits on the board of directors, and at least one politician (e.g., member of parliament, minister, or head of state) sits on the board of directors, and 0 otherwise	<ul> <li>1- Company's annual reports</li> <li>2- Parliament or consultation council website</li> <li>3- Who's Who in the Gulf 2015–2016</li> </ul>
<b>Control Variables</b>		
Firm Age	Natural logarithm of the number of years since the firm was founded	Datastream database
Government	Percentage of government ownership in the company	Bloomberg database
Firm Size	Natural logarithm of the market value of equity	Datastream database
Board Size	Natural logarithm of the total number of directors on the board	Bloomberg database
Leverage	Total debt in year $t$ divided by total assets at the beginning of year $t$	Datastream database

# 7 Empirical results

7.1 Descriptive statistics

Table 3 displays the percentage of the GCC firms, with politically linked directors on the board, then distinguishes the two types of connection, namely royal family connection and non-royal politician connection. It can be seen, on average, that 33% of sample firms are politically connected, while, interestingly, the percentage of royal politically connected firms represents more than the double

percentage of non-royal politically connected firms, with 23% on average for royal politically connected firms and 10% for non-royal politically connected firms. A possible explanation for this may be the firms' belief that the royal family wields the real power and can provide more vital resources than non-royal politicians. Also, there were very few cases in which both a royal family member and a non-royal family politician on the same board of directors were present, which represent only 1.2% of the sample. Furthermore, Table 3 shows that the distribution of political connection has high stability over time.

Table 3 Region Distribution of Firms with Political Connections									
2010 2011 2012 2013 2014 2015									
	Politically connected firms in GCC	33%	32%	32%	32%	33%	33%		
Political Connection in GCC	Royal Family- connected firms in GCC	25%	24%	23%	23%	23%	22%		
	Non-Royal politically connected firms in GCC	8%	8%	10%	9%	10%	11%		

Table 4 shows the percentage of politically connected firms by country. What stands out is that Qatar, on average, has 84% of its firms connected with the royal family, which can reflect the amount of power that the royal family holds. Overall, in Bahrain, Qatar, Saudi Arabia, and UAE, the percentage of royal politically connected firms exceeds the percentage of non-royal politically connected firms. While in Kuwait the percentage is close between royal politically connected firms and non-royal politically connected firms, in Oman the percentage of royal politically connected firms is lower than the percentage of non-royal politically connected firms.

	Country Distribution of Firms v	with Political	Conn	ection	S		
		2010	2011	2012	2013	2014	2015
United Arab	Politically connected firms	48%	48%	52%	48%	50%	47%
Emiratos	Royal politically connected firms	41%	41%	44%	41%	41%	38%
Lilliates	Non-Royal politically connected firms	7%	7%	8%	7%	9%	9%
	Politically connected firms	32%	36%	37%	37%	37%	37%
Bahrain	Royal politically connected firms	24%	24%	27%	27%	27%	27%
	Non-Royal politically connected firms	8%	12%	10%	10%	10%	10%
	Politically connected firms	20%	20%	16%	17%	17%	19%
Saudi Arabia	Royal politically connected firms	17%	17%	14%	15%	14%	14%
	Non-Royal politically connected firms	3%	3%	2%	2%	3%	5%
	Politically connected firms	25%	24%	23%	22%	23%	23%
Kuwait	Royal politically connected firms	15%	14%	12%	11%	10%	10%
	Non-Royal politically connected firms	10%	10%	11%	11%	13%	13%
	Politically connected firms	36%	38%	50%	49%	51%	49%
Oman	Royal politically connected firms	13%	13%	17%	21%	23%	23%
	Non-Royal politically connected firms	23%	25%	33%	28%	28%	26%
	Politically connected firms	92%	90%	88%	88%	88%	88%
Qatar	Royal politically connected firms	88%	85%	83%	83%	83%	83%
	Non-Royal politically connected firms	4%	5%	5%	5%	5%	5%

Table 4 Country Distribution of Firms with Political Connections

Table 5<sup>5</sup> presents descriptive statistics for the dependent variables and control variables in the model. The table shows that the market has positive mean ROE and ROA. The minimum ROE is -120% while the maximum is 64%, and the minimum ROA is -64% while the maximum is 46%. The government ownership is not very high, being on average around 7%. Also, companies do not rely much on debt, which represents on average less than 38%. The average age of firms is less than 24 years, indicating that the firms are quite young.

<sup>&</sup>lt;sup>5</sup> The descriptive statistics for each country are given in the appendix.

Table 5 Descriptive Statistics									
Variable	Mean	Std. Dev.	Min	Max					
ROE	0.08	0.15	-1.20	0.64					
ROA	0.05	0.09	-0.64	0.46					
Government	0.08	0.17	0.00	0.85					
Leverage	0.38	0.22	0.00	0.99					
Size	1427135.00	5260797.00	2200.00	89200000.00					
Bord Size	7.43	1.93	3.00	13.00					
Age	23.45	12.92	1.00	61.00					

# 7.2 Univariate analysis

To better understand how firms differ according to the type of political connection they have, non-politically connected firms have been compared with politically connected firms (see Table 6), royal politically connected firms (see Table 7), and non-royal politically connected firms (see Table 8). Table 9 compares royal politically connected firms with non-royal politically connected firms.

The data in Table 6 illustrate the difference between politically connected and non-connected firms. It can be seen that the mean and median of both ROE and ROA are higher in politically connected firms, compared with non-politically connected ones, and the difference is statistically significant.

Table 6           Descriptive Statistics for Politically connected firms and Non-Connected firms									
Variable	Politically connected firms Not				Non-Connec	ted	t-Test	Kruskal- Wallis Test	
	Ν	Mean	Median	Ν	Mean	Median	(p-Value)	(p-Value)	
ROE	579	0.12	0.10	1399	0.07	0.07	0.00	0.00	
ROA	579	0.07	0.06	1399	0.04	0.04	0.00	0.00	
Government	579	0.13	0.00	1399	0.06	0.00	0.00	0.00	
Leverage	579	0.36	0.35	1399	0.38	0.37	0.11	0.20	
Size	579	2787997.00	521770.00	1399	863919.00	183990.00	0.00	0.00	
Board Size	579	7.99	8.00	1399	7.19	7.00	0.00	0.00	
Age	579	24.88	23.00	1399	22.85	21.00	0.00	0.04	

Table 7 reports the difference between the royal-connected firms and nonpolitically connected firms. The results are similar to those reported in Table 6. The mean and median of both ROE and ROA are significantly higher in royal-connected firms compared with non-politically connected firms. Royal politically connected firms are also significantly larger and older than non-politically connected firms and have significantly larger boards and government ownership. However, they significantly use less debt as source of capital than non-politically connected firms.

Table 7           Descriptive Statistics for Royal politically connected firms and Non-Connected firms									
Variable	Royal p	politically conn	ected firms	-	Non-Connee	cted	t-Test	Kruskal- Wallis Test	
	N	Mean	Median	Ν	Mean	Median	(p-Value)	(p-Value)	
ROE	417	0.13	0.11	1399	0.07	0.07	0.00	0.00	
ROA	417	0.07	0.06	1399	0.04	0.04	0.00	0.00	
Government	417	0.12	0.00	1399	0.06	0.00	0.00	0.00	
Leverage	417	0.34	0.32	1399	0.38	0.37	0.00	0.00	
Size	417	2762268.00	543130.00	1399	863919.00	183990.00	0.00	0.00	
Board Size	417	8.10	8.00	1399	7.19	7.00	0.00	0.00	
Age	417	25.10	23.00	1399	22.85	21.00	0.00	0.06	

Table 8 compares non-royal politically connected firms with non-politically connected firms. In contrast to what is shown in Tables 6 and 7, where non-politically connected firms are compared with politically connected firms and royal politically connected firms, small or no differences in terms of profitably have been found between these two groups of firm. This is somewhat surprising, given that prior research showed a positive significant effect on profitability, resulting from being connected with politicians and demonstrating that politicians are important resource access channels (Wu et al., 2012; Su and Fung, 2013). However, this result suggests that this is not the case in monarchical systems. In terms of control variables, Table 8

shows that non-royal politically connected firms are significantly larger, have significantly larger boards and government ownership, and rely more on debt than non-politically connected firms.

Table 8           Descriptive Statistics for Non-Royal politically connected firms and Non-Connected firms								
Variable	Non-Royal politically connected firms				Non-Connec	t-Test	Kruskal- Wallis Test	
	N	Mean	Median	N	Mean	Median	(p-Value)	(p-Value)
ROE	162	0.10	0.09	1399	0.07	0.07	0.03	0.01
ROA	162	0.05	0.05	1399	0.04	0.04	0.27	0.19
Government	162	0.17	0.05	1399	0.06	0.00	0.00	0.00
Leverage	162	0.42	0.43	1399	0.38	0.37	0.02	0.01
Size	162	2854223.00	375515.00	1399	863919.00	183990.00	0.00	0.00
Board Size	162	7.71	8.00	1399	7.19	7.00	0.00	0.01
Age	162	24.33	28.50	1399	22.85	21.00	0.15	0.27

Table 9 shows the difference between royal-connected firms and non-royal politically connected firms. The table shows statistically significant higher ROE and ROA for royal-connected firms compared with non-royal politically connected firms. This shows that in the GCC royal families are more valuable sources and are able to provide firms with access to key resources to improve firm profitability. In addition, the results show that royal politically connected firms have significantly less government ownership and rely less on debt than non-politically connected firms.

Table 9									
Descriptive Statistics for Royal politically connected firms and Non-Royal politically connected firms									
Variable	Royal p	politically conn	ected firms	N	on-Royal poli connected fi	t-Test	Kruskal- Wallis Test		
	N	Mean	Median	N	Mean	Median	(p-Value)	(p-Value)	
ROE	417	0.13	0.11	162	0.10	0.09	0.00	0.04	
ROA	417	0.07	0.06	162	0.05	0.05	0.00	0.00	
Government	417	0.12	0.00	162	0.17	0.05	0.01	0.01	
Leverage	417	0.34	0.32	162	0.42	0.43	0.00	0.00	
Size	417	2762268.00	543130.00	162	2854223.00	375515.00	0.91	0.01	
Board Size	417	8.10	8.00	162	7.71	8.00	0.04	0.06	
Age	417	25.10	23.00	162	24.33	28.50	0.57	0.89	

Table 10 reports the correlations among the variables in all models and the multicollinearity results for the subsequent regressions. I conducted a formal test to ensure that multicollinearity is not present in my regressions. Therefore, I calculated the variance inflation factor (VIF) for each independent variable included in the estimated model. The highest VIF for the models was well below 5 (the threshold value indicating that multicollinearity may be present (Studenmund, 1997). Thus, I conclude that multicollinearity is not a problem in my sample.

Table 10 Correlation matrix										
	ROE	ROA	Politically connected firms	Royal politically connected firms	Non-Royal politically connected firms	Government	Leverage	Size	Board Size	Age
ROE	1									
ROA	0.89 0.00	1								
Politically connected firms	0.14	0.12	1							
	0.00	0.00								
Royal politically connected firms	0.14	0.14	0.81	1						
	0.00	0.00	0.00							
Non-Royal politically connected firms	0.02	-0.01	0.45	-0.15	1					
	0.47	0.81	0.00	0.00						
Government	0.12	0.13	0.21	0.13	0.15	1				
	0.00	0.00	0.00	0.00	0.00					
Leverage	-0.05 0.03	-0.21 0.00	-0.05 0.02	-0.10 0.00	0.06 0.00	-0.01 0.66	1			
Size	0.33	0.32	0.27	0.25	0.07	0.42	0.14	1		
	0.00	0.00	0.00	0.00	0.00	0.00	0.00			
Board Size	0.23	0.20	0.17	0.17	0.03	0.20	0.05	0.46	1	
Dour a Size	0.00	0.00	0.00	0.00	0.23	0.00	0.01	0.00	1	
Age	-0.01 0.80	0.03 0.16	0.03 0.20	0.01 0.54	0.03 0.23	0.00 0.97	-0.09 0.00	-0.08 0.00	0.00 0.97	1

# 7.3 The effects of firms' political connections

Table 11 shows that political connections have no statistically significant influence on profitability when firms have been classified as politically connected considering the presence of either royal or non-royal politicians. Thus, Hypothesis 1 is not supported. However, Table 12 shows that royal political connections have a significantly positive impact on firms' profitability, both when they were estimated using ROE (Model 3) and ROA (Model 4), while in both models, non-royal political connections have no statistically significant impact. This evidence provides support for Hypothesis 2. The results are in line with what the RDT predicated, as politicians who have seats on firms' boards of directors' work to secure resources and give them preferential advantages; this is reflected in firms' performance as measured in Model 3 and Model 4. The results give further evidence to studies that found firms' political connections enhanced their performance. For instance, the study results are consistent with Shin et al. (2018), who reported that firms that entered into political engagements showed better profitability than those that did not have connections with politicians.

In addition, the results highlight the uniqueness of the study context, which took a different direction than the results of previous studies; it showed no impact of firms' connections with traditional politicians, but it found a positive impact when firms were connected with members of a royal family. These results indicate the importance of considering the study context when examining the implications of firms' political connections, as the GCC has different properties than the contexts of previous studies by having limited parliamentary authority and the presence of royal families that control the state and have vast and influential power.

This result offers a new finding for the literature on firms' political connections, contributing to a better understanding of the effects of firms' political connections on their profitability. Also, this result suggests that the current definition of a politically connected firm is not valid for all ruling systems. Firms that seek to establish connections to obtain resources should strive to build them in collaboration with the actual power holders in their environment. Based on these results, the type of ruling system and sources of the power holder according to the ruling system have to be taken into consideration when examining the impact of firms' political connections.

Table 11								
Political Connections and Profitablilty								
Variable	Variable Model 1 Model 2							
Politically connected firms	0.015	0.009						
Government	-0.108**	-0.036*						
Leverage	-0.132***	-0.120***						
Size	0.042***	0.023***						
Board Size	-0.006	-0.011						
Age	0.008	0.006						
Country Fixed Effect	Yes	Yes						
Industry Fixed Effect	Yes	Yes						
Year Fixed Effect	Yes	Yes						
Constant	-0.431***	-0.205***						
Ν	1978	1978						
r2	0.2178	0.2587						
Max VIF	1.57	1.57						
Mean VIF	1.21	1.21						
	legend: * p<.1; ** p<.05; *** p<.01							
Rando	m-effect GLS regression with robust St	d. Err.						

#### Table 12

	Table 12	
F	Political Connections and Profitablilty	1
Distinguishing between being connected to a royal family member and non-royal politician		
Variable	Model 3	Model 4
Royal politically connected firms	0.027**	0.015**
Non-Royal politically connected firms	-0.013	-0.007
Government	-0.100*	-0.032*
Leverage	-0.129***	-0.118***
Size	0.042***	0.023***
Board Size	-0.005	-0.010
Age	0.007	0.005
Country Fixed Effect	Yes	Yes
Industry Fixed Effect	Yes	Yes
Year Fixed Effect	Yes	Yes
Constant	-0.437***	-0.208***
N	1978	1978
r2	0.2199	0.2612
Max VIF	1.58	1.58
Mean VIF	1.20	1.20
	legend: * p<.1; ** p<.05; *** p<.01	
Rando	m-effect GLS regression with robust St	d. Err.

#### 7.4 Robustness tests

Prior studies suggested that government ownership control could lead to low financial performance, mainly because of preference for political policy and social aims over profitability goals (Sun et al., 2002). Moreover, politicians are more likely to be appointed to the board of directors of government-owned firms as representatives of the government rather than as a way to access resources from the organisational environment. In order to take this into account, all the regression models were run by excluding companies where the government had more than 10% of ownership, as high blockholder ownership tends to affect firms' performance (Thomsen et al., 2006). This reduced the number of firms to 281. All models were estimated using random-effects GLS regression, with robust standard errors and country fixed effect, industry fixed effect, and year fixed effect. Table 13 shows Models 1 and 2, used to test Hypothesis 1, and Table 14 shows Models 3 and 4, used to test Hypothesis 2; consistent with the main results of the study that reported in Tables 11 and 12: only royal-connected connections have a positive and statistically significant influence on firms' profitability.

Further robustness tests were applied by running regressions on lagged dependent variables (see Tables 15 and 16), and the results are consistent with those reported in Table 11 and 12. In addition, different estimation methods were applied in the study by using ordinary least squares (OLS; see Tables 17 and 18), and the results held. Furthermore, although there were very few cases of the presence of both a royal family member and non-royal family politician in the same board of directors, and this scenario was found in only four firms in the sample, the study applied the regression model in the sample after excluding those firms, and the results held (see Tables 19 and 20).

	Table 13	
P	olitical Connections and Profitablilt	У
Variable	Model 1	Model 2
Politically connected firms	0.017	0.011
Government	-0.250	-0.302***
Leverage	-0.151***	-0.109***
Size	0.040***	0.022***
Board Size	-0.012	-0.005
Age	0.014	0.011**
Country Fixed Effect	Yes	Yes
Industry Fixed Effect	Yes	Yes
Year Fixed Effect	Yes	Yes
Constant	-0.424***	-0.222***
Ν	1570	1570
r2	0.1944	0.2292
Max VIF	1.41	1.41
Mean VIF	1.16	1.16
Excluding companies	where the government had more th	an 10% of ownership
	Table 14	
Po	olitical Connections and Profitablilty	1
Distinguishing between bein	g connected to a royal family memb	per and non-royal politician
Variable	Model 3	Model 4
Royal politically connected firms	0.033**	0.020**
Non-Royal politically connected firms	-0.024	-0.015*
Government	-0.221	-0.285***
Leverage	-0.147***	-0.106***
Size	0.040***	0.022***
Board Size	-0.011	-0.004
Age	0.014	0.010*
Country Fixed Effect	Yes	Yes
Industry Fixed Effect	Yes	Yes
Year Fixed Effect	Yes	Yes
Constant	-0.432***	-0.227***
Ν	1570	1570
r2	0.1974	0 2333

legend: \* p<.1; \*\* p<.05; \*\*\* p<.01

1.42

1.16

Max VIF

Mean VIF

Random-effect GLS regression with robust Std. Err.

Excluding companies where the government had more than 10% of ownership

1.42

1.16

Table 15		
Poli	itical Connections and Profitablilty	1
Variable	Model 1	Model 2
Politically connected firms	0.025**	0.008
Government	-0.060	-0.016
Leverage	0.001	-0.068***
Size	0.025***	0.015***
Board Size	0.007	-0.003
Age	0.003	0.004
Country Fixed Effect	Yes	Yes
Industry Fixed Effect	Yes	Yes
Year Fixed Effect	Yes	Yes
Constant	-0.288***	-0.140***
N	1636	1636
r2	0.1845	0.2117
Max VIF	1.57	1.57
Mean VIF	1.21	1.21
le	egend: * p<.1; ** p<.05; *** p<.01	
Random-	effect GLS regression with robust St	td Frr

lagged dependent variables

	Table 16	
ſ	Political Connections and Profitablilty	1
Distinguishing between bei	Distinguishing between being connected to a royal family member and non-royal politician	
Variable	Model 3	Model 4
Royal politically connected firms	0.032**	0.011
Non-Royal politically connected firms	0.004	-0.001
Government	-0.055	-0.014
Leverage	0.003	-0.067***
Size	0.025***	0.015***
Board Size	0.008	-0.003
Age	0.002	0.004
Country Fixed Effect	Yes	Yes
Industry Fixed Effect	Yes	Yes
Year Fixed Effect	Yes	Yes
Constant	-0.293***	-0.142***
N	1636	1636
r2	0.1867	0.2138
Max VIF	1.58	1.58
Mean VIF	1.20	1.20
	legend: * p<.1; ** p<.05; *** p<.01	
Rando	m-effect GLS regression with robust St	:d. Err.

lagged dependent variables

	Table 17	
	Political Connections and Profitablilty	1
Variable	Model 1	Model 2
Politically connected firms	0.007	0.000
Government	-0.057***	-0.025**
Leverage	-0.087***	-0.105***
Size	0.035***	0.021***
Board Size	-0.004	-0.007
Age	0.008	0.006**
Country Fixed Effect	Yes	Yes
Industry Fixed Effect	Yes	Yes
Year Fixed Effect	Yes	Yes
Constant	-0.372***	-0.189***
Ν	1978	1978
r2	0.223	0.262
Max VIF	1.57	1.57
Mean VIF	1.21	1.21
	legend: * p<.1; ** p<.05; *** p<.01	
or	dinary least squares with robust Std. E	rr.

10010 10
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Ρ	Political Connections and Profitablilty	, 
Distinguishing between beir	ng connected to a royal family memb	er and non-royal politician
Variable		IVIOUEI 4
Royal politically connected firms	0.016**	0.005
Non-Royal politically connected firms	-0.014	-0.013**
Government	-0.051**	-0.022*
Leverage	-0.084***	-0.104***
Size	0.035***	0.021***
Board Size	-0.003	-0.007
Age	0.007	0.006**
Country Fixed Effect	Yes	Yes
Industry Fixed Effect	Yes	Yes
Year Fixed Effect	Yes	Yes
Constant	-0.376***	-0.191***
N	1978	1978
r2	0.225	0.264
Max VIF	1.58	1.58
Mean VIF	1.2	1.2
	legend: * p<.1; ** p<.05; *** p<.01	
ord	dinary least squares with robust Std. E	rr.

	Table 19	
Ро	litical Connections and Profitablilt	/
Variable	Model 1	Model 2
Politically connected firms	0.017	0.009
Government	-0.111**	-0.036*
Leverage	-0.134***	-0.120***
Size	0.042***	0.023***
Board Size	-0 004	-0.01
	0.009	0.006
	Vac	Ves
Inductory Fixed Effect	Voc	Voc
Maar Fixed Effect	Yes	Yes
Year Fixed Effect	res	Yes
Constant	-0.441***	-0.20/***
N	1954	1954
r2	0.2204	0.2593
Max VIF	1.57	1.57
Mean VIF	1.19	1.19
le	egend: * p<.1; ** p<.05; *** p<.01	
Random	effect GLS regression with robust S	td. Err.
Excecluding firms with presence of both a re	oyal family member and non-royal family	politician in the same board of director
Excecluding firms with presence of both a re	oyal family member and non-royal family	politician in the same board of director
Excecluding firms with presence of both a re	oyal family member and non-royal family Table 20 litical Connections and Profitablilt	y politician in the same board of director
Excecluding firms with presence of both a re Po Distinguishing between being	Table 20 Itical Connections and Profitablilt connected to a royal family mem	y politician in the same board of director Y ber and non-royal politician
Excecluding firms with presence of both a ro Po Distinguishing between being Variable	Table 20 Table 20 litical Connections and Profitablilt connected to a royal family mem Model 3	y politician in the same board of director Y ber and non-royal politician Model 4
Excecluding firms with presence of both a ro Po Distinguishing between being Variable Royal politically connected firms	Dyal family member and non-royal family Table 20 litical Connections and Profitablilt g connected to a royal family mem Model 3 0.029**	y politician in the same board of director y ber and non-royal politician Model 4 0.016**
Excecluding firms with presence of both a ro Po Distinguishing between being Variable Royal politically connected firms on-Royal politically connected firms	Table 20 Table 20 litical Connections and Profitablilt g connected to a royal family mem Model 3 0.029** -0.013	y politician in the same board of director y ber and non-royal politician Model 4 0.016** -0.007
Excectuding firms with presence of both a response	Table 20 Table 20 litical Connections and Profitablilt g connected to a royal family mem Model 3 0.029** -0.013 -0.103*	y politician in the same board of director y ber and non-royal politician Model 4 0.016** -0.007 -0.032*
Excectuding firms with presence of both a re- Distinguishing between being Variable Royal politically connected firms Government Leverage	Table 20 Table 20 litical Connections and Profitability g connected to a royal family mem Model 3 0.029** -0.013 -0.103* -0.130***	y politician in the same board of director y ber and non-royal politician Model 4 0.016** -0.007 -0.032* -0.118***
Excectuding firms with presence of both a result of the second se	Table 20 Table 20 litical Connections and Profitablilit g connected to a royal family mem Model 3 0.029** -0.013 -0.103* -0.130*** 0.042***	y politician in the same board of director y ber and non-royal politician Model 4 0.016** -0.007 -0.032* -0.118*** 0.023***
Excectuding firms with presence of both a re- Distinguishing between being Variable Royal politically connected firms on-Royal politically connected firms Government Leverage Size Board Size	Table 20 Table 20 litical Connections and Profitability g connected to a royal family mem Model 3 0.029** -0.013 -0.103* -0.130*** 0.042*** -0.001	y politician in the same board of director y ber and non-royal politician Model 4 0.016** -0.007 -0.032* -0.118*** 0.023*** -0.009
Excectuding firms with presence of both a result of the second se	Table 20 Table 20 litical Connections and Profitability g connected to a royal family mem Model 3 0.029** -0.013 -0.103* -0.130*** 0.042*** -0.001 0.008	y politician in the same board of director y ber and non-royal politician Model 4 0.016** -0.007 -0.032* -0.118*** 0.023*** -0.009 0.006
Excectuding firms with presence of both a result of the second se	Table 20 Itical Connections and Profitability g connected to a royal family mem Model 3 0.029** -0.013 -0.103* -0.130*** 0.042*** -0.001 0.008 Yes	y politician in the same board of director y ber and non-royal politician Model 4 0.016** -0.007 -0.032* -0.118*** 0.023*** -0.009 0.006 Yes
Excecluding firms with presence of both a re Distinguishing between being Variable Variable Royal politically connected firms on-Royal politically connected firms Government Leverage Size Board Size Age Country Fixed Effect Industry Fixed Effect	Table 20 Itical Connections and Profitabilit g connected to a royal family mem Model 3 0.029** -0.013 -0.103* -0.130*** 0.042*** -0.001 0.008 Yes Yes	y politician in the same board of director y ber and non-royal politician Model 4 0.016** -0.007 -0.032* -0.118*** 0.023*** -0.009 0.006 Yes Yes
Excecluding firms with presence of both a result of the second se	Table 20 Table 20 litical Connections and Profitability g connected to a royal family mem Model 3 0.029** -0.013 -0.103* -0.130*** 0.042*** -0.001 0.008 Yes Yes Yes Yes	y ber and non-royal politician Model 4 0.016** -0.007 -0.032* -0.118*** 0.023*** -0.009 0.006 Yes Yes Yes
Excectuding firms with presence of both a result of the second se	Table 20 Itical Connections and Profitability g connected to a royal family mem Model 3 0.029** -0.013 -0.103* -0.130*** 0.042*** -0.001 0.008 Yes Yes Yes Yes -0.450***	y politician in the same board of director y ber and non-royal politician Model 4 0.016** -0.007 -0.032* -0.118*** 0.023*** -0.009 0.006 Yes Yes Yes Yes -0.212***
Excecluding firms with presence of both a result of the second se	Table 20 Table 20 litical Connections and Profitability g connected to a royal family mem Model 3 0.029** -0.013 -0.103* -0.130*** 0.042*** -0.001 0.008 Yes Yes Yes Yes Yes 1954	y ber and non-royal politician Model 4 0.016** -0.007 -0.032* -0.118*** 0.023*** -0.009 0.006 Yes Yes Yes Yes Yes -0.212***
Excecluding firms with presence of both a result of the second se	Model 3           0.029**           -0.013           -0.103*           0.042***           -0.001           0.008           Yes           Yes           -0.450***           1954           0.2227	y ber and non-royal politician Model 4 0.016** -0.007 -0.032* -0.118*** 0.023*** -0.009 0.006 Yes Yes Yes Yes -0.212*** 1954 0.262
Excecluding firms with presence of both a result of the second se	Model 3           0.029**           -0.013           -0.103*           -0.130***           0.042***           -0.001           0.008           Yes           Yes           Yes           1954           0.2227           1.57	y ber and non-royal politician Model 4 0.016** -0.007 -0.032* -0.118*** 0.023*** 0.023*** -0.009 0.006 Yes Yes Yes Yes Yes -0.212*** 1954 0.262 1.57
Excecluding firms with presence of both a re Distinguishing between being Variable Variable Royal politically connected firms on-Royal politically connected firms Government Leverage Size Board Size Age Country Fixed Effect Industry Fixed Effect Year Fixed Effect Year Fixed Effect Year Fixed Effect Constant N r2 Max VIF Mean VIF Mean VIF	Table 20         Itical Connections and Profitabilities         g connected to a royal family mem         Model 3         0.029**         -0.103*         -0.130***         0.042***         -0.001         0.008         Yes         Yes         1954         0.2227         1.57         1.19	y ber and non-royal politician Model 4 0.016** -0.007 -0.032* -0.118*** 0.023*** -0.009 0.006 Yes Yes Yes Yes Yes -0.212*** 1954 0.262 1.57 1.19

8 Conclusion

The study sought to investigate the effect of political connections on firm performance in the GCC, which are characterised as absolute monarchical political systems. Relevant and available data were collected for all the listed companies in the GCC during the period of 2010–2015. The study employed a regression analysis methodology to investigate the research questions.

This study relies on the RDT as the main theoretical framework. The RDT offers a compelling logic for the positive effect on performance and profitability of firms, with the presence of a royal family member on the board of directors, especially in an absolute monarchical system. This theory contends that boards of directors help firms in forming ties with (influential) external parties, in securing important resources and opening up access to resources for financing and operating activities that otherwise may not be possible (Goodstein et al., 1994; Fisman, 2001; Pfeffer and Salancik, 1978).

Interestingly, the results of this study show that the "traditional" notion of political connections, as discussed earlier in Section 5—where a firm is claimed to be politically-connected when either an MP, minister, or head of state sits on the board of directors—has no influence on a firm's profitability, which is in contrast to the findings of earlier studies, which follow the "traditional" definition of political connections. Prior studies that use the traditional definition reported either positive (e.g., Li et al. 2008; Wu et al. 2012) or negative effects (e.g., Fan et al. 2007; Jackowicz et al. 2014). However, this study shows that, in an absolute monarchical system, what matters most is for a firm to be connected with the royal family, as this connection leads to significantly higher financial performance. This indicates that a firm's royal connection is a valuable connection in an absolute monarchy, while a connection with non-royal politicians will not provide resources to the connected firms as one would expect; this

gives the impression that there is a property in a country that has an absolute monarchy. This also suggests that, in an absolute monarchical system, the power source that will secure important resources and provide access to resources for operating activities would be the royal family.

The present study contributes to the existing corporate governance and accounting literature by adding knowledge of a new context, that is an absolute monarchy context and the role and power of royal family, which was not sufficiently explored before. The study also adds to the growing body of research, indicating the effect of a firm's political connection on its performance (Li et al., 2008). The study has also broadened our understanding of the effects of political connections on firm performance and profitability. It potentially offers insights to independent regulators, who would benefit from a better understanding of how the presence of royal family members on boards affects firm performance and profitability. The findings may also be helpful to investors and financial analysts, when evaluating firms' future performance.

This study has several limitations that future research should address. First, the study was limited to only GCC countries. Second, it did not test the roles of the politicians in the firms in addition to their involvement in the boards of directors' committees or as executive or non-executive directors. The areas in which politicians operate are expected to show the type and the size of the resources the politicians obtain. Furthermore, the study did not include firms' political connections through firm stock ownership. These limitations should motivate future research to investigate the aforementioned areas. For instance, future research could investigate the effect of firms' political connections via ownership and compare it with the effect of connection through firms' board members. In addition, it would be interesting to

assess the effects of firms' political connections in other monarchies in East Asia and Europe. Also, further research should be undertaken to compare the monarchies with republican systems in terms of firms' political connections as well as between constitutional and absolute monarchies.

# Chapter 3: Empirical analyses of the determinants of the capital structure of firms in the GCC: Political and religious effects

# 1 Introduction

Recent studies on firms' capital structures have shown that having politicians on the board of directors enhances firms' ability to access finance (Mian and Khwaja, 2004; Faccio, 2010; Kostovetsky, 2015; Chen et al., 2014). In most countries, politically connected firms exhibit higher leverage levels than non-connected firms. More notably, politically connected firms show a lower cost of debt than nonconnected firms (Mian and Khwaja, 2004). However, most of the evidence provided by prior studies lack sufficient attention to the effect of royal family connections on capital structure, mainly because these studies only include politicians from parliament and cabinet ministers, ignoring the power of royal families in a monarchy context.

The distinctive balance of power in the monarchical systems suggests that a difference exists in the impact between firm connection with royal family and firm connection with non-royal politicians. Royal family members have substantial political power and influence within the scope of the monarchy. In monarchical countries, royal family members control important state positions and work to maintain the regime (Yom and Gause III, 2012).

There is a growing body of literature that focuses on investigating the influence of religion on firm behaviour (Hess, 2012). Prior research found that firms operating in countries with high levels of religiosity exhibit lower levels of risk exposure (Hilary and Hui, 2009). Moreover, previous studies have examined the association between religion and firms' financial reporting, providing evidence that religiosity is related with low rates of firm financial reporting irregularities, such as

accounting restatements (McGuire et al., 2011). However, the effect of religiosity on the capital structure has seldom been examined, with only one study by Baxamusa and Jalal (2014) who focused on firms located in Protestant- and Catholic-majority countries such as the United States.

This paper aims to extend the literature by examining the effects of firms' political connection and religiosity on their capital structure in a sample of companies listed on the GCC stock markets. Precisely, the current study extends this line of research by investigating the effect on a firm's capital structure when a firm has politicians on its board of directors in a monarchy context and whether being connected with royal family members rather than non-royal politicians would have a different impact. Furthermore, this study explores the impact of classifying firms as religious on their capital structure.

I use data from the GCC mainly because all of its member countries are ruled by royal families and have highly religious societies with clear religious investment rules and explicit identification of stocks as either Islamic or non-Islamic.

The study uses the available data of non-financial firms on all listed companies in the GCC during the period of 2010–2015. I started the sampling period in 2010 to avoid the effects of 2008 financial crisis on the GCC markets. Information on politically connected directors was carefully selected from three sources: (a) companies' annual reports, (b) the parliament or consultation council website of each country except Qatar, as it does not have an official webpage, and (c) the *Who's Who in the Gulf 2015–2016* book issued by Asia Pacific Infoserv, which includes the biographies of the most influential men and women in the GCC. Data on religious classifications were obtained from the list of Al-Mashora & Al-Raya for Islamic financial consultancy.

It has been found in previous studies that firms' political connection would increase their debt and access to more finance (Mian and Khwaja, 2004; Claessens et al., 2008; Leuz and Oberholzer-Gee, 2006). This does not appear to be the case in this study, as it discovered that politically connected firms have a lower leverage than non-politically connected firms. The results seem to be driven by the presence of royal family members rather than traditional politicians. A possible explanation for this difference could be due to the study context, which considers debt undesirable, forcing politicians to avoid making decisions that could damage their public image in society. Concerning the effect of firms' religiosity on their capital structure, this study found that religiosity negatively affects the level of firm leverage, indicating that religion can influence firms financial decisions.

This study contributes to the corporate governance literature in several ways. First, this paper analyses political connection in monarchy contexts by taking into account the roles played by royal families. Only a few studies (e.g., Pérez et al., 2015 in Spain; Chen et al., 2013 in Malaysia) have studied monarchies and analysed political connections in a more traditional way without considering the role of these key players. Second, this study contributes to this literature differently from the previous studies which found that political connections help companies access more loans and have a higher level of leverage (Yeh et al., 2013; Mian and Khwaja, 2004) This study found that royal family connected firms tend to have a lower level of leverage, which indicates that, in countries where debt is not considered desirable, royal family members would strive to meet society's expectations by maintaining a lower level of leverage. In addition, religiosity has been studied in the context of certain accounting/finance issues which, to the best of my knowledge, did not include the effect of firms' religiosity on capital structure. This study contributes to the

capital structure literature by exploring the effects of soft law (religiosity) on firms' financial decisions. This study found that firms religiosity negatively affects the level of firm leverage. It found that firms operating in accordance with the provisions of Islam maintain a lower level of leverage. This finding is consistent with the prior studies that found religion can influence firms' business behaviours, such as firms' risk exposure and financial reporting (Hilary and Hui, 2009; McGuire et al., 2011).

The remainder of the paper proceeds as follows: Section 2 is concerned with the literature review and hypothesis development. Section 3 discusses the methodology employed for this study, including the sample, regression models, and variables. Section 4 explains the study's empirical results. Finally, Section 5 presents the conclusion, including a discussion of the implications of the findings for future research.

#### 2 Literature review and hypothesis development

In recent years, the role of political connections in capital structure has received increased attention from researchers. Empirical studies have found a positive relationship between a firm's political connection and its chance of accessing the debt market or ability to obtain a lower cost of debt. Both in terms of access and cost, political connections support firms to obtain preferential financing (Qian et al., 2011). The RDT specifies that one of the main roles for the board of directors is to offer new resources to the firm. Board members provide their firms with important resources, such as political connections, information, skills, legitimacy, know-how for dealing with bureaucracies, and preferential access to resources (Pfeffer and Salancik, 1978; Boyd, 1990; Hillman and Dalziel, 2003; Goldman et al., 2008). According to the RDT, boards of directors have to ensure a continued supply of resources for the firms' needs including finance (Pfeffer and Salancik, 2003; Pfeffer, 2010). In the

regulated financial industry, ties with politicians play an important role in granting access to finance (Carretta et al., 2012). Through their relationships and influence, politicians facilitate preferential access to finance for connected firms.

Several previous studies have found an impact of the firm's political connection on its capital structure. For instance, Mian and Khwaja (2004) examined political connections and loans in Pakistan by collecting a loan-level data set for more than 90,000 firms for the period 1996–2002. These researchers found that politically connected firms enjoyed preferential treatment; they received 45% larger loans, although they had 50% higher default rates on these loans, suggesting that political connection has a greater bearing on banks' decisions than firms' financial situations. Similarly, Li et al. (2008) examined the effect of entrepreneurs' political relationships in terms of gaining access to the credit market in China, using the amount of loans provided by government banks as a dependent variable and party membership as a proxy for political connection. The study demonstrated that, after controlling for firm characteristics, a significant positive relationship between political connections and the amount of loans obtained from government banks can be observed. Similarly, Houston et al. (2014) conducted a study examining the effects of firms' political connections on access to loans in the United States, using contract-level information on private credit agreements for S & P 500 companies for the period 2003-2008. The researchers found that politically connected firms enjoy a significantly lower cost of loans than non-connected firms, and the results are more pronounced for firms with stronger political connections, indicating that political connections also have an influence on countries with sound law enforcement.

In the same vein, using a data set of Thai firms, Charumilind et al. (2006) conducted an empirical study in Thailand before the Asian crisis of 1997. The study

aimed to investigate the relationship between firms' political connections and preferential access to long-term bank credit in Thailand. The researchers found that politically connected firms had greater access to long-term debt than non-connected firms. Moreover, they found that politically connected firms required less collateral and obtained more long-term loans than non-connected firms. In terms of the effects of political connections for distressed firms when obtaining loans, Joh and Chiu (2004) conducted a study involving non-financial Korean firms. They found that politically connected firms in distress had higher leverage growth rates and displayed lower ex post ability to meet their obligations. This result indicates that, despite published information on firms' bad financial situations, banks maintain their lending to financially distressed firms more than they do to financially healthy firms, which suggests that political connections affect banks' lending decisions more than firms' financial conditions do.

Regarding access to finance in a state-owned bank system, a study conducted in China by Talavera et al. (2012) examined how political connection influenced access to bank financing in a state-owned bank system; the researchers found that political party membership played a vital role in obtaining finance from state-owned banks, while the chance of obtaining loans from commercial banks was improved by spending time in social activities, because it led to establishing business associations, which can assist with loan applications. Similarly, Zheng and Zhu (2013) conducted a study of the "big four" banks that dominate the banking system in China. These banks are controlled by the central or local governments, thereby allowing government officials to have a major influence on their operations, including their lending decisions (Zheng and Zhu, 2013). The study showed that government officials assisted politically connected firms in receiving bank loans, irrespective of their
firms' performance and creditworthiness. The loans were granted to politically connected firms and were accompanied by less monitoring by banks, which increased inefficient investment by managers.

On the same subject, several studies have focused on examining the effects of firm political connection on access to finance and cost of capital during election periods. For instance, Yeh et al. (2013) carried out an empirical study in Taiwan during the 2000 presidential election. The election resulted in the first political switch in more than 50 years from the ruling party Kuomintang (KMT) to the Democratic Progressive Party (DPP). In 2004, the KMT was expected to return to power, but it again lost to the DPP. Yeh et al. (2013) used these two events to examine the effects of political connections on bank loans in Taiwan as well as the effects of the ruling party's influence on the granting of bank loans. The study found that political connections were positively correlated with preferential bank loans in Taiwan, and preferential bank loans differed between the KMT- and the DPP-connected firms according to the entrenched power of the ruling party. The study findings indicated that, prior to the 2000 election, when the KMT was in power, the KMT-connected firms enjoyed higher non-collateral loans from the government-controlled banks than the non-connected firms, which suggests that politically connected firms had a higher level of preferential bank loans. In the post-2000 election period, when the DPP was in power, KMT-connected firms' preferential access to loans changed from noncollateral to collateral loans and from long- to short-term loans, indicating that the power of a KMT connection became weaker in the non-ruling period. While in Taiwan, Chen et al. (2014) conducted an empirical study to investigate whether political connections helped firms gain financial access and obtain preferential loan terms. The study used individual bank loan data during the period 1991-2008 to

examine banks' lending behaviour. The study found that politically connected firms received preferential treatment for both rate and non-rate terms. These firms also obtained additional benefits from the government-owned banks, indicating that government-owned banks are more exposed to political coercion than privately owned banks; consequently, these banks provide higher political rents to politically connected firms. Moreover, connected firms obtain lower loan rates from government-owned banks during election years compared with non-election years (Chen et al., 2014), which means that presidential election years increase the degree of political interference. Furthermore, Claessens et al. (2008) conducted an empirical study in Brazil, which is considered to be among the countries with a high level of interest rates and a low level of financial intermediation. The study used data for both 1998 and 2002 Brazilian elections, and it examined the relationship between political campaign contributions and financial access. The researchers found that firms that made contributions to the (elected) federal deputies increased their leverage level compared with non-contributors, implying that the contributing firms gained preferential access to financing from banks (Claessens et al., 2008). In addition, Chen et al. (2014) investigated the effects of firms' political connections on the obtainment of loans from both private and government banks during election years in Taiwan. The study included individual bank loan data for 1991–2008 to investigate banks' lending behaviour. The researchers showed that the politically connected firms received preferential treatment when accessing loans, and this preference was more significant among the government-owned banks. The study also demonstrated that the cost of loans for politically connected firms was significantly lower during election years.

Having reviewed the studies outlined above, I propose the following hypothesis:

# *Hypothesis 1a:* Politically connected firms have a higher level of leverage than non-connected firms.

However, in a monarchy context, it is important to consider the balance of power, as it differs from other political contexts that have been examined in prior studies (Congleton, 2007).

The royal family is considered the centre of power that governs the state in a monarchy. For example, in Morocco, which is considered a constitutional monarchy, the king enjoys ultimate authority and power, as the constitution is biased in his favour (Maghraoui, 2001). In contrast, in the Hashemite Kingdom of Jordan, which is also considered a constitutional monarchy, the king appoints the Upper House of Parliament, which wields most of the real power in the country, while people vote to elect the Lower House, which has limited authority (Helfont and Helfont, 2012). In addition, the king prepares the lists of reforms needed for the country, which are then given to the prime minister for implementation (Helfont and Helfont, 2012). In the GCC, each regime's autonomy allows the ruling family to enjoy enormous power to control public policies and political commitment (Khalaf and Luciani, 2006). Furthermore, the royal family rules the country in practice, appointing ministers and permitting limited parliamentary authority (Yom and Gause III, 2012). This reinforces the view that royal family members, as opposed to non-royal politicians, have the potential to secure loans for companies and influence the chances of companies obtaining loans. Based on these considerations, I have developed the following hypothesis:

# *Hypothesis 2a:* Royal-connected firms will have a higher level of leverage than non-politically connected firms.

I will now discuss the possible counter hypotheses in relation to Hypothesis 1a and Hypothesis 2a. The national culture participates in shaping how society expects companies to behave (Ringov and Zollo, 2007). The national culture is considered to have a significant influence on firms' capital structure; managerial decisions can be influenced by personalities shaped in accordance with the national cultures (Chang et al., 2012; Ringov and Zollo, 2007). Prior studies have found that capital structure decisions in both developing and developed countries are affected by the same variables; however, there are differences in leverage levels between countries, which suggest the existence of country-specific factors that play a role in capital structure choices (Booth et al., 2001; Stonehill and Stitzel, 1969). Chui et al. (2002) argued that these distinctions are related to the national culture differences between countries. According to Chui et al. (2002), capital structure is affected by the national culture, as it shapes the management's view of the cost and risk involved in obtaining loans. Thus, in countries with a high level of conservatism, firms tend to maintain low levels of debt (Chui et al., 2002). According to Sekely and Collins (1988), cultural factors include a wide range of social norms, which lead to shaping society's behaviour and differentiate one social environment from another.

In their empirical study, Sekely and Collins (1988) tested the relationship between the national culture and firm capital structure, using a sample of 677 firms from 23 countries, which were then divided into groups based on countries that share similar cultural attributes. The study found that culture has a significant effect on firms' capital structure. The country groupings used in the study were based on Broek and Webb's (1973) work, which developed cultural models that classified the world

into homogeneous groupings, including Anglo-American, Latin American, West Central Europe, Mediterranean, Scandinavia, Indian Peninsula, and Southeast Asia. The groups of Southeast Asian, the Latin American, and the Anglo-American were found to have low debt ratios. While the groups of the Scandinavian, Mediterranean, and Indian Peninsula were found to have high debt ratios. The differences in the level of debt in each group is argued to be related to each society's attitudes towards risk and debt.

In the GCC, where the member countries share the same language (Arabic) and have similar cultures, discouragement of obtaining loans from state institutions is a common feature; such financing is recognised as a source of problem, which should be avoided. For instance, the Saudi Arabian monetary authority stated that borrowing may be the beginning of a major financial crisis, which affects people's financial situation and income, leading to an endless cycle of problems (Sama, 2018). This societal view of debt pushes politicians to preserve their public image and meet society's expectations by maintaining low levels of leverage in countries that discourage indebtedness; their public image is damaged when, either through their actions or those of others close to them, they fail to meet these expectations. Based on this point, I hypothesise the following for both types of political connection:

*Hypothesis 1b:* Politically connected firms have a lower level of leverage than non-connected firms.

*Hypothesis 2b:* Royal-connected firms will have a lower level of leverage than non-politically connected firms.

Next, I develop a hypothesis concerning the effect of religiosity on capital structure. Religion affects corporate finance behaviour because corporate decision makers' opinions on risks and rewards are affected by their beliefs (Baxamusa and

Jalal, 2014). People who have a religious upbringing tend to exhibit similar beliefs, even if they stop following religion as adults (Guiso et al., 2003). Research in personnel psychology has shown that employees' religion and that of other stakeholders affects a firm's behaviour (Baxamusa and Jalal, 2014).

For instance, Hilary and Hui (2009) found that firms' religious leanings are an important consideration for employees who are seeking new jobs. For example, the study tests a sample of chief executive officers (CEOs) who changed the company they worked for in the period from 1991 to 2003 in the US. The study found that, after controlling for CEO and firm characteristics, the CEOs were more likely to choose a firm that maintained a similar religious environment to the firm that they left. This demonstrates that religion influences management and firms' decisions. In addition, their study found that firms operating at a high level of religiosity tend to have a lower rate of risk exposure, measured by variances in return on equity (ROE) or return on assets (ROA), and a lower investment rate and growth (Hilary and Hui, 2009). Furthermore, researchers have been interested in investigating the relationship between religion and financial reporting. For instance, McGuire et al. (2011) examined the possible relationship between religion and the chance of financial reporting irregularities and earnings management. The study measured religious social norms by utilize a database of over 610,000 interviewing in the US; the findings illustrated that religiosity was associated with lower accounting risk and lower cases of financial reporting irregularities. Furthermore, the study found evidence that religiosity was negatively associated with abnormal accruals. This indicates that religiosity impacts firms' financial reporting. Furthermore, Callen and Fang's (2015) study examined the relationship between religiosity—with reference to the location of firms headquartered at different levels of religiosity intensity-and

future stock price crash risk. The study found that religiosity was negatively associated with future stock price crash risk, mainly because firms whose headquarters were in locations with high levels of religiosity displayed low levels of future stock price crash risk (Callen and Fang, 2015).

In Islam, followers are discouraged from being burdened with heavy debts, as this can lead to risky consequences (Sipon et al., 2014). Prophet Muhammad (Peace Be Upon Him) regularly supplicated, "Allah, I seek refuge with you from sin and heavy debts" (reported by Bukhari and Muslim). He (Peace Be Upon Him) further stated, "whoever dies free from three things: arrogance, cheating and debt will enter paradise and the soul of a believer is held hostage by his debt in his grave until it is paid off" (reported by Tirmidhi). Furthermore, He (Peace Be Upon Him) further stated, "Oh God, I seek refuge in you from the predominance of debts, and the dominance of the enemy, and the gloating of enemies". Based on this discussion, I hypothesise the following:

# *Hypothesis 3: Islamic companies have lower leverage compared with non-Islamic companies.*

#### 3 Methodology

#### 3.1 Sample

I initially collected data on all listed companies in the GCC during the period 2010–2015. The initial sample size was 661 firms with yearly observations, but 152 firms were removed because of unavailable data, bankruptcy, or having delisted from the stock market; thus, the sample was reduced to 509 firms. Then, I removed financial industry firms because of their distinctive capital nature (Rajan and Zingales, 1995), resulting in 285 firms and 1,440 firm-year observations. I started the sampling period in 2010 to avoid the effects of the financial crisis on the GCC markets, while 2015 had the latest available data when the study began. Information

on politically connected directors was carefully selected from the following three sources: (a) the companies' annual reports, (b) the parliament or the consultation council website for each country except Qatar, and (c) *Who's Who in the Gulf 2015–2016*. Al-Mashora & Al-Raya's list for Islamic financial consultancy was used to identify the Islamic-listed stocks in these stock markets. See Table 1 for the source of each variable.

3.2 Variables

#### **3.2.1 Dependent variables**

The dependent variable in my regression model is the leverage ratio of company i in year t, which is the total debt of company i in year t divided by the total assets of company i in year t. The data on the total debt and total assets were obtained from Datastream.

#### 3.2.2 Independent variables

#### **Political connection variables**

The definition of politically connected directors is critical for this study. Consistent with Faccio et al. (2006) and Faccio (2010), firms are considered politically connected when at least one politician (e.g., an MP, minister, head of state, or a person closely related to a top official) sits on the board of directors. However, the definition of political connection developed by Faccio (2010) did not take into account the royal family as an important element in the context of monarchical systems. Royal families are key political actors in monarchy contexts (Magaloni, 2008). For this reason, this study also considers a firm to be politically connected when at least one member of the royal family sits on the board of directors. The characteristics of political connections differ from politician to politician, and these affect their power and authority according to the context. Firms connected with a royal family member are expected to gain greater access to resources than those firms connected with non-royal politicians. Therefore, I use two different political connection variables to analyse whether a difference exists in the effect on the capital structure of royal politically connected firms and non-royal politically connected firms. I considered firms to be connected with royal families, when at least one member of the royal family sat on the board of directors; I also considered firms that had non-royal political connection when no royal family member sat on the board of directors, and at least one non-royal politician (e.g., an MP, minister, or head of state) sat on the board of directors.

#### The religiosity variable

The GCC countries that are the subject of my study have a large Muslim population, with both Islamic and non-Islamic stocks listed in the same market. Like Al-Awadhi and Dempsey (2017), I follow the list of Al-Mashora & Al-Raya for Islamic financial consultancy to identify the Islamic-listed stocks in the stock markets. In this study, I used a dummy variable for the Islamic screening strategy by assigning a value of 1 to the stocks of Islamic companies and 0 to the stocks of non-Islamic companies.

#### **3.2.3** Control variables

#### Firm size

Prior empirical studies have suggested a positive relationship between firm size and leverage ratio. This is suggested to be due to decreases in bankruptcy costs as firm size increases (Gruber and Warner, 1977). Furthermore, Titman and Wessels (1988) suggested that large firms are more diversified. Small firms tend to have lower leverage ratios because of possible liquidation when facing financial issues (Ozkan, 1996). Like Ozkan (2001), Rajan and Zingales (1995) and Titman and Wessels (1988), I employed the natural logarithm of sales as a proxy for firm size.

#### Growth opportunities

Prior literature has suggested a negative relationship between growth opportunities, consisting of future investment opportunities and the leverage ratio. Although growth opportunities are capital assets, they cannot be collateralised, and they do not produce current revenue (Ozkan, 2001). They are intangible in nature, and their value depends on the company continuing to operate. Their value drops precipitously in the case of financial crises, which lead to high bankruptcy costs when the growth opportunities are high (Myers, 1984; Harris and Raviv, 1990). The growth opportunities are considered to be firms' risky assets, and loans against them may end up reducing their value (Myers, 1984).

Following Smith et al. (1992), Rajan and Zingales (1995), and Ozkan (2001), I use the ratio of the market value of assets to the book value of assets as a proxy for growth opportunities. The proxy is defined as the ratio of the book value of the total assets minus the book value of equity, plus the market value of equity to the book value of total assets.

#### **Profitability**

Pecking order theory suggests that firms prefer using retained earnings as their first choice when financing their investment and projects, while debt financing comes second and equity issues come as the last choice (Myers, 1984). Moreover, an abnormally profitable firm that has a slow growth rate is expected to have an abnormally low leverage rate, compared with other firms in the same industry (Ozkan, 2001). Following Titman and Wessels (1988), Whited (1992), and Ozkan (2001), I measure profitability as the ratio of earnings before interest, tax, and depreciation of the total assets.

#### Liquidity

Firms' liquidity ratios could have different effects on their leverage ratio. For instance, firms that have a high liquidity ratio could have a high leverage ratio because of their ability to meet their short-term obligations (Ozkan, 2001). In other cases, firms that have a high liquidity ratio could use their liquid assets for funding their projects instead of acquiring debts (Ozkan, 2001). This situation suggests that liquidity ratios may have a mixed effect on the leverage ratio (Ozkan, 2001). Like Ozkan (2001), I use the ratio of current assets to current liabilities as a proxy for the liquidity of firms' assets.

#### **Tangibility**

According to static trade-off theory, tangible assets play an important role when firms plan to access the debt market, as these will be used as collateral for debts. Tangible assets would lower the bankruptcy risk of the firm, as they could be used in case of defaults on the debt. Thus, firms that obtain a high level of tangible assets are expected to have a relatively high level of debt. This relationship has been

confirmed empirically in the developed countries (Titman and Wessels, 1988; Rajan and Zingales, 1995). In developing countries, empirical studies have shown mixed results. For example, a positive relationship between tangibility and leverage has been found in Thailand and South Korea (Wiwattanakantang, 1999; Um, 2001). However, in China, an empirical study found a negative relationship between tangibility and leverage (Huang, 2006). Following Rajan and Zingales (1995), I define tangibility as fixed assets divided by total assets. Furthermore, I control for the effect of the industry, country, and year in the study. Table 1 summarises the variables used in the study.

Table	1
-------	---

Variable	Definition	Source
Leverage	Total debt divided by total assets	Datastream database
Politically connected firms	Equals 1 when at least one member of the royal family, member of parliament, minister, or head of state sits on the board of directors, and 0 otherwise	<ol> <li>Companies' annual reports</li> <li>Parliament or consultation council website</li> <li>Who's Who in the Gulf 2015–2016</li> </ol>
Royal politically connected firms	Equals 1 when at least one member of the royal family sits on the board of directors, and 0 otherwise.	<ol> <li>Companies' annual reports</li> <li>Parliament or consultation council website</li> <li>Who's Who in the Gulf 2015–2016</li> </ol>
Non-royal politically connected firms	Equals 1 when no royal family member sits on the board of directors and at least one politician (e.g., member of parliament, minister, or head of state) sits on the board of directors, and 0 otherwise.	<ol> <li>Companies' annual reports</li> <li>Parliament or consultation council website</li> <li>Who's Who in the Gulf 2015–2016</li> </ol>
Religiosity	Takes value of 1 if the company operates in accordance with the provisions of Islamic law, and 0 otherwise	Al Mashora and Al Raya
Firm size	Natural logarithm of sales	Datastream database
Growth Opportunities	(Total assets—total shareholders' equity + market value) / (total assets)	Datastream database
Profitability	EBITD divided by total assets	Datastream database
Liquidity	Current assets divided by current liability	Datastream database
Tangibility	Fixed assets divided by total assets	Datastream database

3.3 Regression model

The two models below were applied to estimate the effect of the firms' political connection on their capital structure and to examine the effect of operations in accordance with the provisions of the Islamic law on the firms' capital structure.

Model 1

$$\begin{aligned} Leverage &= \beta_0 + \beta_1 \text{Politically connected firms}_{it} + \beta_2 \text{ Religiosity}_{it} \\ &+ \beta_3 \text{ Firm size}_{it} + \beta_4 \text{ Growth Opportunities}_{it} \\ &+ B_5 Profitability_{it} + B_6 \text{Liquidity}_{it} + \beta_7 Tangibility_{it} \\ &+ i. Country + +i. Industry + i. year \end{aligned}$$

Model 2

 $\begin{aligned} Leverage &= \beta_0 + \beta_1 \text{Royal politically connected firms}_{it} \\ &+ \beta_2 \text{ Non - Royal politically connected firms}_{it} \\ &+ +\beta_3 \text{ Religiosity}_{it} + \beta_4 \text{ Firm size}_{it} \\ &+ \beta_5 \text{ Growth Opportunities}_{it} + B_6 Profitability_{it} \\ &+ B_7 \text{Liquidity}_{it} + \beta_8 Tangibility_{it} + i. Country + +i. Industry \\ &+ i. year \end{aligned}$ 

4 Empirical results

#### 4.1 Descriptive statistics

Table 2 shows an overview of the mean, standard deviation, minimum, and maximum of all the variables included in the tested sample. The table shows that the mean leverage level for the sample is around 38%, while the minimum is 1.3% and the maximum is 98.5%. The mean profitability for the sample is 10.8%, while the

minimum is -61.7% and the maximum is 57.7%. The sample shows a high level of current ratio with a mean of 2.46, while the minimum is 0.05 and maximum is 33.63.

Table 2       Descriptive Statistics							
Variable	Obs	Mean	Std. Dev.	Min	Max		
Leverage	1,440	0.39	0.21	0.01	0.99		
Size	1,440	12.05	1.79	1.39	17.74		
Growth Opportunities	1,440	1.48	0.94	0.32	8.91		
Profitability	1,440	0.11	0.09	-0.62	0.58		
Liquidity	1,440	2.46	2.62	0.05	33.63		
Tangibility	1,440	0.38	0.25	0.00	0.94		

#### 4.2 Univariate analysis

Table 3 compares the politically connected firms with the non-connected firms. It can be seen from the table that the difference in the mean and median leverage between the two groups is not considerable or statistically significant. Moreover, it can be seen that the size of politically connected firms is large in terms of both mean and median compared with non-connected firms, and this difference is statistically significant. For profitability, it can be seen that the politically connected firms have higher mean and median profitability than the non-connected firms, and the difference is statistically significant; this may be related to the resources provided by politicians, which enhance the connected firms' profitability. No significant difference was founded in relation to tangibility.

	Table 3								
D	escriptive Statistics for Politic	ally connec	ted firms	and Non-Conne	ected firms				
	stats	Leverage	Size	Growth Opportunities	Profitability	Liquidity	Tangibility		
Non-Connected	mean	0.39	11.80	1.52	0.10	2.55	0.38		
	p50	0.38	11.85	1.22	0.10	1.63	0.36		
	Ν	972.00	972.00	972.00	972.00	972.00	972.00		
Politically connected firms	mean	0.38	12.58	1.38	0.12	2.29	0.37		
	p50	0.38	12.63	1.25	0.11	1.53	0.35		
	Ν	468.00	468.00	468.00	468.00	468.00	468.00		
	t-test (P-Value)	0.76	0.00	0.01	0.01	0.08	0.63		
	Kruskal-Wallis test (P-value)	0.96	0.00	0.80	0.00	0.17	0.78		

Table 4 compares the firms connected with royal families with the nonconnected ones. It can be seen that the firms that are connected with royal families have lower mean and median leverage compared with the non-connected ones, and the difference is statistically significant, which supports Hypothesis 2b. Furthermore, the table shows that the mean and median of the size and profitability of firms connected with royal families are larger than those that are not connected, and the differences are statistically significant. For the current ratio, the table shows that firms connected with royal families have statistically higher mean, while the median did not show a statistically significant difference. In regard to growth opportunities and tangibility, the table shows no statistically significant difference in both mean and median.

Table 4 Descriptive Statistics for Royal politically connected firms and Non-Connected firms								
	stats	Leverage	Size	Growth Opportunities	Profitability	Liquidity	Tangibility	
Non-Connected	mean	0.39	11.80	1.52	0.10	2.55	0.38	
	p50	0.38	11.85	1.22	0.10	1.63	0.36	
	Ν	972.00	972.00	972.00	972.00	972.00	972.00	
Royal politically connected firms	mean	0.36	12.64	1.43	0.13	2.15	0.39	
	p50	0.36	12.70	1.30	0.12	1.62	0.38	
	Ν	321.00	321.00	321.00	321.00	321.00	321.00	
	t-test (P-Value)	0.05	0.00	0.15	0.00	0.02	0.35	
	Kruskal-Wallis test (P-value)	0.08	0.00	0.20	0.00	0.63	0.22	

Table 5 compares the firms with non-royal connected politicians and the nonconnected firms. The table shows that firms with non-royal connected politicians enjoy higher mean and median leverage than the non-connected ones, and the difference is statistically significant. In addition, the connected firms show larger mean and median size than the non-connected ones, and the difference is statistically significant. In regard to growth opportunities, the table shows that the firms with nonroyal connected politicians have statistically lower mean, while the median has no statistically significant difference. The table shows that there is no statistically significant difference in both mean and median in regard to profitability. Moreover, the table shows that the firms with non-royal connected politicians have statistically lower current ratio median, while the mean has no statistically significant difference. Furthermore, the table shows that the firms with non-royal connected politicians have statistically lower tangibility in both mean and median.

Table 5           Descriptive Statistics for Non-Royal politically connected firms and Non-Connected firms							
	stats	Leverage	Size	Growth Opportunities	Profitability	Liquidity	Tangibility
Non-Connected	mean	0.39	11.80	1.52	0.10	2.55	0.38
	p50	0.38	11.85	1.22	0.10	1.63	0.36
	Ν	972.00	972.00	972.00	972.00	972.00	972.00
Non-Royal politically connected firms	mean	0.43	12.43	1.27	0.10	2.59	0.33
	p50	0.43	12.54	1.18	0.09	1.37	0.29
	Ν	147.00	147.00	147.00	147.00	147.00	147.00
	t-test (P-Value)	0.01	0.00	0.01	0.40	0.87	0.02
	Kruskal-Wallis test (P-value)	0.01	0.00	0.13	0.40	0.04	0.01

Table 6 compares the firms with royal connection with the firms that have no royal-connected politicians. The table shows that the royal-connected firms have much lower mean and median leverage than the non-royal connected firm, and the difference is statistically significant. Moreover, the table shows that the royalconnected firms enjoy higher levels of profitability compared with the firms that have no royal-connected politicians, and the difference is statistically significant; this is related to the power held by the royal family, which could be used to obtain resources for the connected firms and improve its profitability. In regard to size, the table shows no statistically significant difference in both mean and median. For growth opportunities and tangibility, the table shows that royal-connected firms have statistically higher mean and median. Moreover, the table shows that royal-connected firms have statistically lower current ratio, while the median shows no statistically significant difference.

Table 6           Descriptive Statistics for Royal politically connected firms and Non-Royal politically connected firms							
	stats	Leverage	Size	Growth Opportunities	Profitability	Liquidity	Tangibility
Royal politically connected firms	mean	0.36	12.64	1.43	0.13	2.15	0.39
	p50	0.36	12.70	1.30	0.12	1.62	0.38
	Ν	321.00	321.00	321.00	321.00	321.00	321.00
Non-Royal politically connected firms	mean	0.43	12.43	1.27	0.10	2.59	0.33
	p50	0.43	12.54	1.18	0.09	1.37	0.29
	Ν	147.00	147.00	147.00	147.00	147.00	147.00
	t-test (P-Value)	0.00	0.21	0.01	0.00	0.04	0.00
	Kruskal-Wallis test (P-value)	0.00	0.34	0.02	0.00	0.12	0.00

In general, the results in the above tables are interesting, mainly because the firms that have connections with royal family members and non-royal politicians take different directions. The connection with non-royal politicians, as the traditional political connection, works in the traditional way with increasing level of leverage, which is in line with Hypothesis 1a and the main finding of previous research. Firm connection with royal family members takes a new direction with decreasing level of leverage, leverage, which in line with Hypothesis 2b.

Table 7 compares the Islamic and non-Islamic companies. The table shows that Islamic companies have lower mean and median leverage compared with non-Islamic companies, and the difference is statistically significant; this supports Hypothesis 3. In addition, the table shows that Islamic companies have a smaller mean and median in both growth opportunities and size compared with the non-Islamic companies, and the difference is statistically significant. Furthermore, the table illustrates that the Islamic companies have lower mean and median profitability compared with the non-Islamic companies, and the difference is statistically significant; this could be related to the Islamic Shariah boundaries. For instance, the Islamic Shariah prohibits excessive uncertainty about assets or prices in exchanges, interest, and gambling (Ayub, 2015; Alawadhi, 2016). Furthermore, the table shows that the Islamic companies have statistically higher median current ratio, while the median shows no statistically significant differences. In regard to tangibility, the table shows no statistically significant differences between the Islamic and non-Islamic companies in both mean and median.

#### Table 7

	Descriptive Statistics for Religiosity firms and Non-Religiosity firms									
	stats	Leverage	Size	Growth Opportunities	Profitability	Liquidity	Tangibility			
Non-Religiosity	mean	0.40	12.11	1.49	0.11	2.46	0.38			
	p50	0.40	12.11	1.23	0.10	1.57	0.36			
	Ν	1314.00	1314.00	1314.00	1314.00	1314.00	1314.00			
Religiosity	mean	0.27	11.46	1.31	0.09	2.52	0.38			
	p50	0.25	11.24	1.15	0.09	2.01	0.40			
	Ν	126.00	126.00	126.00	126.00	126.00	126.00			
	t-test (P-Value)	0.00	0.00	0.03	0.03	0.79	0.92			
	Kruskal-Wallis test (P-value)	0.00	0.00	0.02	0.05	0.02	0.87			

Table 8 reports the correlations among the variables across all models and suggests that multicollinearity does not affect subsequent regressions, although I conducted a formal test to ensure that multicollinearity would not be present in my regressions. I calculated the variance inflation factor (VIF) for each independent variable included in the estimated model. The highest VIF for our models was well below 5 (the threshold value indicating that multicollinearity might be present (Studenmund, 1997)). Thus, I conclude that multicollinearity is not a problem in my sample.

Table 8 Correlation matrix											
	Leverage	Politically connected firms	Royal politically connected firms	Non-Royal politically connected firms	Religiosity	Size	Growth Opportunities	Profitability	Liquidity	Tangibility	
Leverage	1										
Politically connected firms	-0.05	1									
	0.02										
Royal politically connected firms	-0.10	0.82	1								
	0.00	0.00									
Non-Royal politically connected firms	0.07	0.45	-0.15	1							
	0.00	0.00	0.00								
Religiosity	-0.15	-0.13	-0.12	-0.04	1						
	0.00	0.00	0.00	0.04							
Size	0.39 0.00	0.18 0.00	0.14 0.00	0.09 0.00	-0.13 0.00	1					
Growth Opportunities	-0.09	-0.03	0.00	-0.05	-0.07	0.08	1				
	0.00	0.23	0.87	0.03	0.00	0.00					
Profitability	-0.13	0.11	0.12	0.00	-0.13	0.34	0.34	1			
	0.00	0.00	0.00	0.91	0.00	0.00	0.00				
Liquidity	-0.12	-0.02	-0.02	-0.01	-0.01	-0.29	-0.02	-0.05	1		
	0.00	0.31	0.35	0.76	0.58	0.00	0.36	0.03			
Tangibility	0.12	-0.04	0.02	-0.10	0.02	0.11	0.08	0.15	-0.07	1	
	0.00	0.04	0.48	0.00	0.31	0.00	0.00	0.00	0.01		

4.3 Multivariate analysis

#### 4.3.1 Effects of firms' political connections and religiosity

This section analyses the results derived from Models 1 and 2, as shown in Table 9. The results in the table are based on random effects ordinary least squares (OLS) regression with a robust standard error. The results are related to the impact of political connections on firms' capital structure. The current study found evidence of a new direction for political connection to affect firms' capital structure. Prior studies found that firms' ties with politicians lead to an increase in firms' leverage levels, as they facilitated firms' access to the debt market (Mian and Khwaja, 2004, Li et al., 2008). The political connection allowed firms to have preferential treatment when entering the finance market. For instance, Li et al. (2008) found that firms' political connections helped them to access the credit market in China and positively affect the amount of loans they obtained from government banks (Li et al., 2008). This is consistent with what the RDT predicts, as it considers that it is the duty of the board of directors to enable the firm's access to finance and secure resources. According to the RDT, the board members' role is not limited to the managing of the firm – they must also secure the resources that the firm needs and helps the firm when it enters the debt market to obtain the money it needs through borrowing.

However, the results of this research showed two main findings that differ from what previous studies reported; this is due to the uniqueness of the study context. First, no results indicated that traditional political connections affected firms' capital structure. This result provides evidence that in monarchy contexts, non-royal politicians are not capable of influencing firms' capital structure. This evidence highlights that the traditional definition of political connection, which does not include royal family members, is not applicable to monarchy contexts, as traditional politicians do not have the power to influence firms' capital structure.

Second, this study shows that royal political connections play a role in reducing firms' leverage levels, which is a new direction of thought regarding political connections' impact on firms' capital structure. This contradictory result is explained by the fact that the societies in which the politicians work are against debt,

as Hypotheses 1b and 2b predict. The results reveal evidence that politicians are concerned with their societal images.

Turning to the results related to the Islamic effect on firms' capital structure, Table 9 shows that firms' religiosity has a negative effect on their leverage levels, which supports Hypothesis 3: Islamic companies have lower leverage than non-Islamic companies. This result indicates that firms' religiosity has implications for their business behaviour. The finding is consistent with the literature, which found that religion affects firms' business behaviour, such as firm risk exposure and firm financial reporting (Hilary and Hui, 2009, McGuire et al., 2011).

Table 9									
Political Connections and Capital Strcture									
. <b>I</b>									
Leverage	Model 1	Model 2							
Politically connected firms	-0.0511***								
	(0.01)								
Royal politically connected firms		-0.0710***							
		(0.01)							
Non-Royal politically connected firms		-0.016							
		(0.01)							
Religiosity	-0.127***	-0.129***							
	(0.01)	(0.01)							
Size	0.0474***	0.0467***							
	0.00	0							
Growth Opportunities	-0.0084	-0.00869							
	0	0							
Profitability	-0.581***	-0.563***							
	(0.08)	(0.08)							
Liquidity	-0.0284***	-0.0288***							
	0.00	0.00							
Tangibility	0.0588**	0.0597**							
	(0.02)	(0.02)							
Constant	-0.0891*	-0.076							
	(0.04)	(0.04)							
Country Fixed Effect	Yes	Yes							
Industry Fixed Effect	Yes	Yes							
Year Fixed Effect	Yes	Yes							
R2	0.4811	0.4852							
Max VIF	1.28	1.28							
Mean VIF	1.16	1.15							
Ν	1,440	1,440							
Robus	t Standard errors in parentheses								
* p<	<0.05, ** p<0.01, *** p<0.001								
The models are estimated using Rar	ndom-effects OLS regression with	h Robust Standard errors and							
country tixed effec	ct, industry fixed effect and year	fixed effect.							

#### 4.4 Robustness tests

With the aim of preventing autocorrelation in the model, I used lagged dependent variables for both models. Table 10 shows the results of the models using random-effects OLS regression with robust standard errors with all the dependent variables lagged. It can be seen from the table that the results hold. Then, I used a panel data procedure, namely random-effects GLS regression with a robust standard for two cases, as follows: lagged dependent variables and non-lagged dependent variables (see table 11 and 12). All the results were consistent, showing the negative effects of royal connections and religiosity on firms' leverage levels, as well as the absence of statistically significant effects of non-royal politicians on firms' leverage levels. These results provide supporting evidence for Hypotheses 2b and Hypotheses 3. Also, to control for government control, I applied the models using random-effects OLS for the firms with lower than 10% government ownership, and the results held (see table 13). Furthermore, although there were few cases of the presence of both a royal family member and non-royal family politician on the same board of directors, with this scenario found in only four firms in the sample, the study applied the regression model in the sample after excluding those firms, and the results held (see table 14). Turning to the results related to the Islamic effect on firms' capital structure, the results showed support for what was expected in Hypothesis 3, as it states that the Islamic firms would have lower leverage compared with the non-Islamic firms. The Islamic companies were expected to be influenced by Islamic teachings, which were found not to encourage debt, thus they maintain low levels of leverage compared to other non-Islamic ones. This result is important as it is the first, to best of my knowledge, which indicates the impact of companies' classification as Islamic on their capital structure.

Table 10								
Political Connections and Capital Strcture								
Leverage	Model 1	Model 2						
Politically connected firms	-0.0522***							
	(0.01)							
Royal politically connected firms		-0.0667***						
		(0.01)						
Non-Royal politically connected firms		-0.0263						
		(0.02)						
Islamic	-0.126***	-0.127***						
	(0.01)	(0.01)						
Size	0.0485***	0.0480***						
	0.00	0.00						
Growth Opportunities	-0.0133*	-0.0135*						
	(0.01)	(0.01)						
Profitability	-0.578***	-0.566***						
	(0.08)	(0.08)						
Liquidity	-0.0265***	-0.0267***						
	0.00	0.00						
Tangibility	0.0500*	0.0505*						
	(0.02)	(0.02)						
Constant	-0.0892	-0.0794						
	(0.05)	(0.05)						
Country Fixed Effect	Yes	Yes						
Industry Fixed Effect	Yes	Yes						
Year Fixed Effect	Yes	Yes						
R2	0.4618	0.464						
Max VIF	1.29	1.29						
Mean VIF	1.16	1.15						
N	1,173	1,173						
Robust S <sup>i</sup>	tandard errors in parentheses	5						
* p<0.	05, ** p<0.01, *** p<0.001							
The medale are estimated using Dand.	and officiate OLC regression with	h Dahust Chandand amang and						

The models are estimated using Random-effects OLS regression with Robust Standard errors and country fixed effect, industry fixed effect and year fixed effect. All dependent variables are Lagged

Table 11								
Political Connections and Capital Strcture								
Leverage	Model 1	Model 2						
Politically connected firms	-0.0415							
	(0.02)							
Royal politically connected firms		-0.0620*						
		(0.03)						
Non-Royal politically connected firms		0.00273						
		(0.02)						
Religiosity	-0.135***	-0.138***						
	(0.03)	(0.03)						
Size	0.0426***	0.0421***						
	(0.01)	(0.01)						
Growth Opportunities	-0.00742	-0.00774						
	(0.01)	(0.01)						
Profitability	-0.283***	-0.275***						
	(0.08)	(0.08)						
Liquidity	-0.0154***	-0.0153***						
	0.00	0.00						
Tangibility	0.0622	0.0633						
	(0.04)	(0.04)						
Constant	-0.0855	-0.0758						
	(0.11)	(0.11)						
Country Fixed Effect	Yes	Yes						
Industry Fixed Effect	Yes	Yes						
Year Fixed Effect	Yes	Yes						
R2	0.4465	0.4492						
Max VIF	1.28	1.28						
Mean VIF	1.16	1.15						
Ν	1440	1440						
Robust	Standard errors in parentheses							
* p<	0.05, ** p<0.01, *** p<0.001							
The models are estimated using Ran	dom-effects GLS regression with	۱ Robust Standard errors and						
country fixed effect, industry fixed effect and year fixed effect.								

Table 12 Political Connections and Capital Strcture				
Leverage	Model 1	Model 2		
Politically connected firms	-0.0457*			
	(0.02)			
Royal politically connected firms		-0.0553**		
		(0.02)		
Non-Royal politically connected firms		-0.0181		
		(0.02)		
Religiosity	-0.128***	-0.128***		
	(0.03)	(0.03)		
Size	0.0396***	0.0391***		
	(0.01)	(0.01)		
Growth Opportunities	-0.00412	-0.0043		
	(0.01)	(0.01)		
Profitability	-0.180*	-0.174		
	(0.09)	(0.09)		
Liquidity	-0.00871**	-0.00868**		
	0.00	0.00		
Tangibility	0.102*	0.103*		
	(0.05)	(0.05)		
Constant	-0.082	-0.075		
	(0.08)	(0.08)		
Country Fixed Effect	Yes	Yes		
Industry Fixed Effect	Yes	Yes		
Year Fixed Effect	Yes	Yes		
R2	0.3806	0.3821		
Max VIF	1.29	1.29		
Mean VIF	1.16	1.15		
Ν	1173	1173		
Robust Standard errors in parentheses				
* p<0.05, ** p<0.01, *** p<0.001				

The models are estimated using Random-effects GLS regression with Robust Standard errors and country fixed effect, industry fixed effect and year fixed effect. All dependent variables are Lagged

Table 13 Political Connections and Capital Strcture				
Politically connected firms	-0.042***			
Royal politically connected firms		-0.066***		
Non-Royal politically connected firms		0.004		
Religiosity	-0.126***	-0.128***		
Size	0.054***	0.054***		
Growth Opportunities	0	0		
Profitability	-0.466***	-0.444***		
Liquidity	-0.029***	-0.030***		
Tangibility	0.036	0.04		
Constant	-0.179***	-0.164**		
Country Fixed Effect	Yes	Yes		
Industry Fixed Effect	Yes	Yes		
Year Fixed Effect	Yes	Yes		
R2	0.528	0.534		
Max VIF	1.26	1.26		
Mean VIF	1.14	1.14		
Ν	1,094	1,094		

### \* p<0.05, \*\* p<0.01, \*\*\* p<0.001

The models are estimated using Random-effects OLS regression with Robust Standard errors and country fixed effect, industry fixed effect and year fixed effect. For firms with lower than 10% government ownership

Table 14           Political Connections and Capital Strcture				
Politically connected firms		Widdel 2		
Folitically connected minis	-0.040			
Royal politically connected firms		-0.067***		
Non-Royal politically connected firms		-0.017		
Religiosity	-0.128***	-0.130***		
Size	0.048***	0.047***		
Growth Opportunities	-0.009	-0.009*		
Profitability	-0.582***	-0.566***		
Liquidity	-0.028***	-0.029***		
Tangibility	0.053*	0.055*		
Constant	-0.089*	-0.077		
Country Fixed Effect	Yes	Yes		
Industry Fixed Effect	Yes	Yes		
Year Fixed Effect	Yes	Yes		
R2	0.484	0.488		
Max VIF	1.28	1.28		
Mean VIF	1.15	1.15		
Ν	1,419	1,419		

### \* p<0.05, \*\* p<0.01, \*\*\* p<0.001

The models are estimated using Random-effects OLS regression with Robust Standard errors and country fixed effect, industry fixed effect and year fixed effect after excluding firms with presence of both a royal family member and non-royal family politician in the same board of directors

#### 5 Conclusion

Prior corporate governance literature has suggested a relationship between economic transactions, including bank credit and political power. Collectively, these studies outline the critical role of political forces in that they grant access to finance with low fees and preferential terms (Qian et al., 2011; Mian and Khwaja, 2004; Claessens et al., 2008).

A political connection was also found to affect firms' capital structure by working in increasing their level of debts (Faccio, 2010). In this study, I strove to shed new light on these issues by examining political connection in a monarchy context. Specifically, I examined the effects of the presence of political connections through non-royal politicians and royal family members on firms' leverage level. While in regard to the effect of religion impact on firms' business behaviour, the topic has received considerable attention from researchers (Hess, 2012). Previous studies have examined the impact of religion on firm risk exposure, which leads to lower levels in high religiosity countries (Hilary and Hui, 2009). Furthermore, prior studies found that religiosity is related to lower rates of firm financial reporting irregularities, such as accounting restatements (McGuire et al., 2011). However, up to now, little attention has been paid to the effects of religiosity on firms' capital structure, thus motivating me to examine such effects.

In contrast to the previous literature which found that political connections allow companies to obtain more debt (Mian and Khwaja, 2004; Bliss and Gul, 2012; Claessens et al., 2008), my study shows that political connection has the opposite effect, as politically connected firms have lower leverage than non-politically connected firms. The results seem to be driven by the presence of royal family

members rather than traditional politicians. Prior studies found that political connection increases the level of debts, as politicians provide connected firms with preferential access to the debt market (Claessens et al., 2008). Prior studies provide evidence for the RDT, which states that it is the duty of board members to provide their firms with resources they need. However, the contrary finding in this study could be explained by that, in countries where debt is not considered favourable, politicians would avoid making decisions that could damage their public image and result in failure to meet the society's expectations; therefore, the connected firms would maintain lower level of debts. These findings suggest that politicians would strive to reflect the society's values when they assume membership in a firm's board of directors, which support Hypotheses 1b and 2b. In addition, the result of this study reveals that the power to affect firms' capital structure in a monarchical system is held by the royal family, indicating that, in terms of political ties, only royal family members and non-royal politicians can influence firms' capital structure, which provides evidence for Hypothesis 2b.

Turning to the effects of religiosity on firm capital structure, I found that religiosity negatively affects the level of firm leverage. More precisely, Islam discourages its followers from being burdened with heavy debt, as this could lead to risky consequences. The results of this study showed that this perception is reflected in firms' operation in accordance with the provisions of Islam. This finding is consistent with what has been found in prior studies in regard to the impact of religion on firm behaviour. The prior studies found that religion affects firms' business behaviour, such as firm risk exposure and firm financial reporting (Hilary and Hui, 2009; McGuire et al., 2011).

This research contributes to the literature on the relationship between political connection and capital structure in several ways. First, unlike previous literature, I conducted the study in a monarchy context, representing a clearer level of power held, as royal blood relatives control important state positions. I investigated the effects of political connection through royal and non-royal figures, which helps shed light on the relationship between firms' political ties and their capital structure. Thus, I provided novel evidence that, in a monarchy context, the ability to affect firms' capital through political connection only occurs in relation to royal family ties. Second, the study presented new evidence of the effects of political connections on firms' capital structure, which was not found in previous studies. The study found the negative effect of political connection in relation to firms' leverage levels, which could be linked to the societies being not much in favour of debt in which the politicians work. Therefore, these findings contribute greatly to the political connection literature. Third, the study contributes to the literature on capital structure by making an initial move in examining firm religiosity effect on its capital structure. This study appears to be the first to provide evidence on this topic. Moreover, conducting the study in a highly religious context assisted in achieving a better understanding of firms' religiosity.

The study results have important implications that may be generalised to other settings with similar institutional characteristics. First, the findings highlight the effects of board composition on firms' capital structure. For instance, the study demonstrates that political connections have an important influence on the level of debts that firms obtain. Furthermore, the findings reported in this paper also have implications for firms' political connection literature, as they emphasise the important role of royal family members as power holders in monarchy contexts. The study's

results also underline the importance of firms' religiosity in their financing decisions, and this is especially useful for managers and auditors interested in understanding firms' capital structure.

This study has several limitations that further research should address. First, the study did not examine the effect of political connection on the cost of debt. Furthermore, due to the data limitations, the study did not examine the effect of firms' political connections on the terms of debt contracts, nor did it investigate whether connected firms enjoy preferential treatment. In addition, the study did not examine the effect of firms' political connections through ownership on its capital structure. Finally, it did not explore the effect of firms' political connections on collateral requirements when obtaining loans.

This study suggests several avenues for future research. First, it would be interesting to assess the effects of political connection on debt cost in monarchical systems and measure political connections through ownership. Furthermore, future studies could explore the effects of firms' political connections on the terms of its debt contracts and collateral requirements. The other effects of firms' religiosity, such as the effects on transparency, debts cost or performance, should also be investigated.

### Chapter 4: Political connections during political conflict: Evidence from the GCC political crisis

#### 1 Introduction

This study aims to investigate the impact of political connection on stock market performance during periods of political crisis. In particular, by analysing monarchical political systems, it aims at analysing the differences in stock market performances between firms with royal connections and non-royal connections in response to political crises. It also aims to analyse whether the degree of a country's involvement in the crisis has any impact on politically connected companies. Despite their importance, these questions are presented for the first time within the field of firms' political connection through this research. They gain significance when considering the importance of firms' political connections in giving access to companies' preferential borrowing rates (Mian and Khwaja, 2004), preferential access to government procurement contracts (Goldman et al., 2008), enjoy more protection of their own property rights (Hellman et al., 2003), and pay tax at significantly lower effective rates (Adhikari et al., 2006). However, an important aspect that has not been subjected to investigation yet is how the market would respond towards politically connected firms in the event of political crises, which would put firms' political patronage under threat to stay in power. The purpose of the current study is to investigate the reaction of the stock market towards politically connected firms through either royal family members or non-royal politicians and also towards non-politically connected firms during political crises, which took place in monarchy contexts. This research gains importance through the new way of looking at the relationship between political patronage and the firm compared to what was viewed in the previous studies. In particular, prior studies see politicians as

sources to ensure access to resources and a way to overcome the environment uncertainty, while this study sees the relationship from the point of politicians' risks and how this would be reflected on connected firms.

Previous studies in the field have examined the impact of economic consequences of political uncertainty from different perspectives. For instance, Julio and Yook (2012) conducted a study that investigated the impact of uncertainties related to the potential changes in government policy or national leadership on the firms' business behaviours. The study found that, during political uncertainty, firms' decrease their investment expenditures, and the level of firms' investment expenditures will rise to its normal levels when the uncertainty is resolved. Furthermore, Chau et al. (2014) investigated the economic consequences of the Arab Spring, which started when a Tunisian vegetable vendor set himself ablaze to protest against police corruption. The study showed that the series of protests increased the volatility in the region's financial markets. Moreover, Bonaime et al. (2018) conducted a study that investigated the effect of political uncertainty on firms Merger and Acquisition (M & A), finding a negative association. However, there is a marked lack of studies that focus on the effect of uncertainty on the continuation of firms' political patronage in the event of a change in power structures and its implications for the performance of politically connected firms. The study conducted by Fisman (2001) is one of the few in this area. He focused on the former Indonesian president Suharto, the news about his deteriorating health, and the reactions of the firms listed on Jakarta Stock Exchange, which had a particular connection with him. The study found that politically connected firms were more negatively affected than limitedbond firms, indicating that investors valued resources obtained through political connections.
The current study is based on the RDT theory in the construction of its hypotheses and the explanation of its results. The RDT states that board members provide their firms with important resources, such as political connections, information, skills, legitimacy, and the ability to overcome government bureaucracy (Boyd, 1990; Pfeffer and Salancik, 1978; Hillman and Dalziel, 2003; Goldman et al., 2008). The members of the firms' boards of directors are expected to manage the firms' environmental uncertainty and lower their associated costs (Pfeffer and Salancik, 1978). Therefore, politicians with seats on firms' boards of directors are expected to provide these firms with power and preferential access to vital resources. However, during political crises, which could threaten firms' political patronage power, it is expected to have negative consequences on firms that have ties with them, because as patronage power becomes a risk, the resources and the influence obtained by the firms' patronage will be a risk too. The study focuses on the GCC, as its study context, and uses 612 companies, listed on the stock exchanges of the six GCC countries.

This study aims to provide a deeper understanding of and new perspectives on the effect of firms' political connections on their performance. The new perspectives are the occurrences of political crises between countries and their effect on politically connected firms. The study is unusual in considering an event, which takes place in a monarchy context, distinguishing between firms with ties to the royal family and those without such ties, to provide greater insights into the impact of a political crisis on politically connected firms. Furthermore, the study takes into account the degrees of political crises, according to the level of county involvement in the crises, and determines how differences in the levels of political uncertainty were reflected in the performance of politically connected firms.

The remainder of the paper proceeds as follows: Section 2 provides a review of the literature related to the topic of firms' political connections and political uncertainty. Section 3 develops the hypotheses tested in the study. Section 4 is concerned with political crisis. Section 5 relates the methodology employed for the study, including the sample, regression models, and variables. Section 6 presents the study's empirical basis, and Section 7 presents the conclusion, including a discussion of the implications of the findings for future research.

### 2 Literature review

A growing body of evidence found advantages that firms gain from maintaining ties with politicians because politicians, through their political power, are able to secure important resources for those firms (Li et al., 2008; Wu et al., 2012; Faccio, 2006). Politicians are believed to have significant social power in the environments in which organisations operate, which enables them to affect the performance of organisations (Pfeffer, 2010). The time needed for firms to obtain political power is shorter than the time required to gain economic power, yet it lasts longer in most cases, making it an attractive source of strength (Mitchell and Hayes, 1984). Although having political power may not be the ultimate goal of firms, it is a tool that is used to support their economic activity (Boddewyn and Brewer, 1994).

There are various ways for firms to obtain political power, the most wellknown method being to offer a seat to a politician on the organisation's board of directors. Board members provide their firms with important resources (Boyd, 1990; Pfeffer and Salancik, 1978; Hillman and Dalziel, 2003; Goldman et al., 2008). According to the RDT theory, firms are open systems that can be directly and indirectly affected by external forces (Pfeffer, 2010). Firms work to lower the level of environmental uncertainty, especially regarding vital resources, by maintaining

control over such factors. In this perspective, firms are viewed as coalitions, building their structure and forming their boards in a way that lead to maintain important external resources (Ulrich and Barney, 1984). It is the role of the board of directors to manage environmental uncertainty and lower its associated costs (Pfeffer and Salancik, 1978). Prior studies have associated firms' boards of directors with providing firms with resources and enhancing firms' performance (Hillman and Dalziel, 2003). Therefore, when politicians take a seat in a firm's board of directors, it is expected that this would empower the firm in its environment and obtain preferential access to vital resources.

Previous research on the effect of firms' political connections on their performance has shown that political connections play a positive role in firms' financial activities, including securing government bail-outs and preferential allocation of government funds. In addition, prior studies found that government capital is more likely to be invested in politically connected firms than in nonpolitically connected ones. For example, Duchin and Sosyura (2012) investigated the effects of firms' political connections on their eligibility to participate in the Capital Purchase Program (CPP), the first and largest Troubled Asset Relief Program (TARP) in the United States. They found that, after controlling for firms' characteristics, there was a positive association between firms' political connections and the likelihood of them obtaining application approval. In addition, earlier studies found that politically connected firms enjoy preferential treatment when obtaining finance in terms of both the size and cost of loans. For instance, Mian and Khwaja (2004) conducted an empirical study in the context of Pakistan to examine the effect of firms' political connections on obtaining loans. This study found that politically connected firms enjoyed preferential treatment, receiving 45% more loans in terms of size, even

though they had a 50% higher default rate on those loans. Furthermore, it has been found that firms' political activity has positive implications on firms' IPO day (Gounopoulos et al., 2017). In a study conducted by Gounopoulos et al. (2017), it has been found that the firms' political money contributions (PMC) reflected positively in the firms' IPO day and in the aftermarket period their shares witnessed lower volatility compared with non-PMC. Moreover, previous studies have also found that political connections positively influence firms' market value. For example, Goldman et al. (2008) studied the effects of political connections on firms' value in the United States. The study examined the effects of two events on firms' market value, namely the 2000 presidential election and the appointment of politically connected directors to the firms' boards of directors (Goldman et al., 2008). The study found that the portfolios of firms connected with the Republican Party showed a positive and significant cumulative abnormal return (CAR), following the narrow defeat of the Democratic nominee Al Gore by the Republican candidate George W. Bush. By contrast, the portfolios of firms connected with the Democratic Party showed a negative CAR following the election (Goldman et al., 2008). In addition, the study showed that the companies had a positive and statistically significant abnormal stock return after declaring the selection of a politically connected board member (Goldman et al., 2008). Similarly, it has been found that political connections have a positive impact on firms' profitability. Su and Fung (2013) studied China in the period 2004–2008 to examine the relationship between firms' political connections and their profitability. The study showed a positive effect of political connections on firms' performance and demonstrated the channels, through which the positive influence of political connections function, including higher cash holdings, larger long-term debts,

lower debt costs, higher sales, and lower sales costs, which all enhance firms' performance (Su and Fung, 2013).

The economic consequences of political uncertainty have also attracted the attention of researchers, with scholars arguing that it can cause significant market volatility (Schneider and Troeger, 2006). In 2011, Standard and Poor stated that political uncertainty in the United States was the key reason for its first-ever downgrade of US Treasury debt (Kelly et al., 2016). Furthermore, a so-called fake tweet that an attack had been carried out on the White House and that the former president of the US, Obama, was hurt caused chaos in the stock market. According to Elboghdady (2013), "a fake tweet about an attack on the White House briefly roiled the financial markets on Tuesday afternoon, sending stocks tumbling within minutes". Moreover, changes of government leaders or the entrance of new political parties to govern the country have affected both stock markets and the country's fiscal and monetary policies (Kim and Mei, 2001).

Civil war is considered to be one of the worst cases of political uncertainty, because its impact on the economy is usually severe. In Africa, political instability is recognised as a main element in discouraging investment in the region and raising operational costs (Guidolin and La Ferrara, 2007). Countries that are exposed to political crises or international sanctions, due to their political activities, suffer from negative consequences of their economies and of firms that operate within them. For instance, the United Nations Security Council (UNSC) imposed an economic embargo on Iraq, as a result of its invasion of Kuwait on 2 August 1990. This was followed by the freezing of Iraq's overseas assets and the suspension of all trading and financial transactions with the country, causing a tremendous impact on the economy, with hyperinflation, a depressed economy, and depreciation of the Iraqi

currency (Al-Roubaie and Elali, 1995). The political crisis brought about by the ruling regime in Iraq at that time resulted in these economic losses and led to the loss of investor confidence.

The uncertainties related to the potential changes in government policy or national leadership have implications for the firms' behaviours (Julio and Yook, 2012). Investors have to choose the best time to commit to investment projects and prefer to postpone potential projects in the hope that new information will reduce uncertainty about the future of political stability, improving the accuracy and success of investment decisions (Bernanke, 1983). For instance, Julio and Yook (2012) conducted an empirical study based on 248 national elections in 48 countries held between 1980 and 2005. They presumed that the relationship between electoral uncertainty and firms' behaviours were based on the strong likelihood of an adverse election outcome which, from the firms' perspective, meant that delaying investment decisions were preferable until uncertainty was resolved. The study found that, in the pre-election period, investment expenditure decreased by an average of 4.8%. Additionally, the level of decline was found to vary from country to country; the more difficult it was to predict election outcomes, the higher the decline in investment expenditure. Moreover, the study found that the impact of national elections was more serious for firms that operated in highly politically sensitive industries (Julio and Yook, 2012). Furthermore, political uncertainty has been found to affect firms' stock market performance by increasing stock volatility and risk premium (Pástor and Veronesi, 2013). Moreover, Chau et al. (2014) conducted an empirical study that focused on the effect of the Arab Spring, which started when a Tunisian vegetable vendor set himself ablaze to protest against police corruption, initiating a wave of protest in the Arab world and associated political uncertainty

resulting in stock market volatility. The study found that political uncertainty due to the Arab Spring led to increased volatility in the region's financial markets. Furthermore, political uncertainty has been found to lead to higher corporate debt financing costs (Waisman et al., 2015). For example, an empirical study conducted by Waisman et al. (2015) that investigated the political uncertainty associated with the outcome of the US presidential elections found that it led to a 34-basis point rise in corporate bond spreads. The reasons for this rise are explained by two main causes. First, the political uncertainty could lead to an increase in the risk of default, which causes higher bond spreads (Cremers and Yan, 2009). Second, the possibility of losing political connection, which secure resources and enhance firms' performance (Waisman et al., 2015). Furthermore, political uncertainty has been found to be negatively associated with firms Merger and Acquisition (M & A) (Bonaime et al., 2018). According to an empirical study by Bonaime et al. (2018), which uses the US companies sample from 1985 to 2014 and quantifies the index of policy uncertainty, political uncertainty has been found to significantly impact on the firms' business environment and cause firms' managers to change their behaviours, including their dealings of M & A.

Nevertheless, most of the prior studies in political uncertainty literature have mainly focused on political events, such as elections, wars, and terrorist attacks (Chau et al., 2014). The threat of political turnover for politically connected firms has attracted little attention from the scholarly community, despite continuing political stability being essential for the political patronage of politically connected firms. Uncertainty regarding the state of firms' political patronage can have negative effects on politically connected firms, because the established political connections can be weakened or lost. According to the RDT, politicians are expected to provide

protection and assure vital resources for their connected firms, as politicians are considered key influential actors in firms' environments (Pfeffer and Salancik, 2003). However, when the firms' political patronage power is unsure about the continuation of political issues or even health issues, this is expected to be reflected negatively on the companies associated with them, because the influence that has been provided by that politician may not continue, leading to deterioration in the activities and performance of the company. To date, limited studies have been performed to investigate the impact of the threat of political turnover to politically connected firms (e.g., Fisman, 2001; Li et al., 2018). Fisman (2001) examined the reaction of politically connected firms on the Jakarta Stock Exchange to the news about former President Suharto's health. He identified several incidents, involving adverse rumours regarding the state of Suharto's health and examined the reaction of politically connected and less politically connected firms, based on their market return during the incidents. The study found that the returns of politically connected firms were considerably lower than the returns of less politically connected firms, which was linked to the investors' fear of losing the resources, obtained as a result of Suharto's political power. In addition, Li et al. (2018) investigated how the change of a local government official would impact firms' cost of equity of Chinese firms in general and then with additional analyses that focus on politically connected firms. The study found that during periods of political uncertainty, the firms' cost of equity increased. In addition, the study found that when the firm CEO/chairman is politically connected, the adverse effect is stronger (Li et al., 2018).

A considerable amount of literature has been published on political uncertainty in relation to business environment. Those studies investigate the sources of the political uncertainty, including civil war (Guidolin and La Ferrara, 2007),

international economic embargo (Al-Roubaie and Elali, 1995), national elections (Julio and Yook, 2012), protest (Chau et al., 2014), and national leader health issue (Fisman, 2001). Moreover, the effects of political uncertainty has been studied at the national economy level (Guidolin and La Ferrara, 2007) and firms' levels (Bonaime et al., 2018). However, previous studies have not investigated the political crises between countries as a source of political uncertainty, nor the effect of political crises between countries on politically connected firms. Therefore, this study intended to fill this knowledge gap in the literature by using the event of GCC political crises, which took place on 2017. On June 5, the biggest political crisis in the Middle East in years started when Bahrain, Saudi Arabia, the UAE announced economic embargoes on Qatar and severed ties with this country (Hunt, 2017). They accused Qatar of "embracing various terrorist and sectarian groups aimed at destabilizing the region." (Lister, 2017). The study investigated the impact of this political crisis on politically connected firms in the GCC. Furthermore, the study investigated the effect of the involvement level of the country and its effect on politically connected firms inside it. In addition, this study distinguished between firms with traditional political connection, which do not include any royal family member, and firms with royal connections to investigate the possible differences in the impact of this political crises on them.

# 3 Hypothesis development

Previous studies have shown that firms' political connections improve the profitability of companies by offering them preferential business deals. The presence of politicians on the boards of directors of companies is key to obtaining resources and privileges, as predicted by the RDT. The theory holds that board members act as channels for their firms' access to important external resources, such as political

connections, information, skills, legitimacy, and the ability to overcome government bureaucracy (Pfeffer and Salancik, 1978; Boyd, 1990; Hillman and Dalziel, 2003; Goldman et al., 2008). However, as discussed above, any threat to the existence and continuation of political power has implications for the political patronage of politically connected firms (Li et al., 2018; Fisman, 2001). Prior studies indicate that political uncertainty has an influence on the returns of firms in the stock market (Goodell and Vähämaa, 2013). Firms' stock prices tend to reflect political uncertainty (Goodell and Bodey, 2012). For example, Li and Born (2006) found that, prior to the US presidential elections, the stock prices witnessed an increase as the results of the election were uncertain. While in case of politically connected firms, political uncertainty is expected to cause panic among investors, because the resources that have been obtained by the politicians are consequently under threat of discontinuation, having a negative impact on firms' profitability, and the greater the doubt about the continuation of political patronage, the more negative is the reaction of investors.

Thus, I hypothesise the following:

*Hypothesis 1a:* In the event of a political crisis, companies with political ties will be more affected than others in regard to stock market performance.

*Hypothesis 1b:* In the event of a political crisis, companies with royal family member ties will be more affected than others in regard to stock market performance.

In a monarchy context, it is believed that the sources of power are in the hands of members of the royal family, since they control the country and formulate its policies. For example, in the first paper of this thesis, the study focused on the impact of firms' political connections on their profitability. The study found that the association of the companies with members of the royal family had a positive impact on the firms' profitability but did not find a statistically significant impact of the non-royal political associations on the firms' profitability. Furthermore, the second paper of this thesis studied the impact of the firms' political connections on their capital structure. The study found that only connections with royal family members had an impact on firms' capital structure; being connected with non-royal politicians did not have a statistically significant impact on the firms' capital structure. This indicates that when political crises occur in a monarchy context, the negative impact will be greater for firms with royal connections than others, due to the resources that may be lost as a result of the royal family's loss of power.

This leads to the third hypothesis:

*Hypothesis 2:* In a monarchy context, firms with royal connections will experience a more negative impact than those with no royal connections when political crises occur.

The level of a country's involvement in the political crises is expected to affect the degree of implication for firm's stock market returns. The more the strength of political crises is, the more it is expected to lead to more reaction on firms' stock returns, as the political actions are closely followed by stock market participants who alter their valuations based on the results of these events (Li and Born, 2006). For example, Kelly et al. (2016) conducted an empirical study to analyse the pricing of political uncertainty by using option protection against risks associated with political events for 20 countries. The study found that political uncertainty is priced in the option market and that the higher political uncertainty, the higher the value of option protection. Therefore, it is expected that, in case of political crises among a number of

countries, the firms located in the countries involved directly in the crises would face higher levels of political risk. This leads to the third hypothesis:

*Hypothesis 3a:* Politically connected firms in the countries directly involved in the conflict would experience a greater negative effect than those in indirectly involved countries.

*Hypothesis 3b:* Royal politically connected firms in the countries directly involved in the conflict would experience a greater negative effect than those in indirectly involved countries.

4 The event

The GCC political crisis began on 5th June 2017 when Bahrain, Saudi Arabia, and the UAE decided to sever their ties with Qatar. The severing of relations involved withdrawing ambassadors and imposing trade and travel bans. Kuwait called for restraint, and both Kuwait and Oman remained neutral during the crisis. The Saudiled coalition declared Qatar a supporter of terrorism; Qatar's official reaction was that these actions were a "violation of its sovereignty" and it denied all the allegations. Precisely, Qatar was accused of providing support to Muslim Brotherhood organisation, which is considered a terrorist group according to the Saudi-led coalition. Moreover, the coalition considered Oatar being far too cordial with Iran, which is considered Saudi regional main rival (Tharoor, 2017). Furthermore, it is argued that foreign policy of Qatar diverges from other members of the GCC, and it has used its extensive wealth of oil and natural gas to impose its own agenda on other countries (Tharoor, 2017). Moreover, Qatar's state-funded news network, Al Jazeera, is considered one of the reasons that caused the Saudi-led coalition to accuse the network of promoting hostile news in regard to the coalition countries (Solomon, 2017).

This political crisis had a negative effect on Qatar's economy in particular and caused panic in the country. In the early hours of the crisis, commodities and basic food supplies started to run out due to the panic, since Qatar relies on import of approximately 40% of its basic supplies through the border with Saudi Arabia (BBC, 2017). Flights to and from Qatar were suspended by Bahrain, Saudi Arabia, and the UAE. More than 18 flights from Qatar International Airport were cancelled, which appeared overwhelming on the first day of the crisis (BBC, 2017). In addition, Qatari vessels were banned from Saudi ports. The Saudi Ports Authority notified to shipping agents that they should not receive vessels carrying Qatari flags or if they are owned by Qatari companies or individuals. The UAE ports also rejected Qatari vessels. Furthermore, the negative economic impact of the crisis on Qatar affected the international companies, as Saudi Arabia urged foreign companies to avoid trading with Qatar, implicitly asking them to choose sides in the conflict and indicating that they could not trade with Saudi Arabia and Qatar simultaneously (Reuters, 2017). Furthermore, the crisis affected the major international constructors who won bids to build eight stadiums, a new metro system, and 60,000 hotel rooms for the Qatar 2022 World Cup. However, due to ongoing trade sanctions, which disrupted building plans, made them consider departure or downsizing of their Qatar projects (Withers, 2017).

5 Methodology

This study employed event study methodology to investigate the impact of political crises on stock market return for politically connected firms. The objective of an event study is to evaluate the extent to which firm stock market price has changed due to an event (Sorescu et al., 2017). Researchers are frequently interested in measuring the economic consequences of an event on financial markets and firms' market value. By deploying financial market data, an event study measures the

impact of a specific event on the value of a firm (MacKinlay, 1997). The strength of this methodology relies on the fact that, given rationality in the marketplace, the financial markets will immediately reflect the effects of any security-related event (MacKinlay, 1997). This method is particularly useful in studying the impact of political crises on politically connected firms, as it allows to isolate the expected value that firms will gain or lose due to an event that has been acknowledged by the public (Sorescu et al., 2017).

# 5.1 The sample and model

An event study has four component parts (Bhagat and Romano, 2002). First, the event, that is the GCC political crises, which took place on 5<sup>th</sup> of June 2017. Second, measuring the stock's return during the announcement period. Third, estimating the expected return in the absence of the event. The estimation window used in this study to estimate the return in the absence of the event is -120 and -20, based on the "market model". Four, calculating the abnormal return (actual return minus expected return) for the period [-10 and 10], and then measuring its statistical significance. The study's sample consisted of 612 companies, listed on the GCC stock exchanges during the event.

The actual return is as follows:

$$R_{it} = \alpha_i + \beta_i R_{mt} + \varepsilon_{it}$$

Since the firms were listed in six different counties, the market index for each country was used to establish the market return.

$$AR_{it} = R_{it} - \hat{\alpha}_i - \hat{\beta}_i R_{mt}$$

(Where  $R_{it}$  is the daily stock return *i* during the event window *t* [-10, 10], and  $R_{mt}$  is the market return).

When using the regression method, the sample was reduced to 583, due to the unavailability of control variable data.

5.2 Regression models

 $\begin{aligned} CAR0 &= \beta_0 + \beta_1 \text{Politically connected firms} + \beta_2 \text{Direct} \\ &+ \beta_3 \text{ Politically connected firms} * \text{Direct} + B_4 \text{ Momentum} + \beta_5 \text{ NI} \\ &+ \beta_6 \text{ BoardSize} + \beta_7 \text{ Leverage} + \beta_8 \text{ Size} + \beta_9 \text{ MB} \\ &+ \beta_{10} \text{ Government} + \beta_{11} \text{ MC}_6 \text{DP} + i. Industry \end{aligned}$   $\begin{aligned} CAR \left[ 0 + 1 \right] &= \beta_0 + \beta_1 \text{Politically connected firms} + \beta_2 \text{Direct} \\ &+ \beta_3 \text{ Politically connected firms} * \text{Direct} + B_4 \text{ Momentum} + \beta_5 \text{ NI} \\ &+ \beta_6 \text{ BoardSize} + \beta_7 \text{ Leverage} + \beta_8 \text{ Size} + \beta_9 \text{ MB} \\ &+ \beta_{10} \text{ Government} + \beta_{11} \text{ MC}_6 \text{DP} + i. Industry \end{aligned}$   $\begin{aligned} CAR \left[ -1 + 0 + 1 \right] \\ &= \beta_0 + \beta_1 \text{Politically connected firms} * \text{Direct} + B_4 \text{ Momentum} + \beta_5 \text{ NI} \\ &+ \beta_6 \text{ BoardSize} + \beta_7 \text{ Leverage} + \beta_8 \text{ Size} + \beta_9 \text{ MB} \\ &+ \beta_{10} \text{ Government} + \beta_{11} \text{ MC}_6 \text{DP} + i. Industry \end{aligned}$ 

 $\begin{aligned} CAR0 &= \beta_0 + \beta_1 \text{Royal} + \beta_2 \text{Direct} + \beta_4 \text{ Royal} * \text{Direct} + \beta_5 \text{Non} \\ &- \text{Royal Politician} + B_6 \text{Non} - \text{Royal Politician} * \text{Direct} \\ &+ B_7 \text{ Momentum} + \beta_8 \text{ NI} + \beta_9 \text{ BoardSize} + \beta_{10} \text{ Leverage} \\ &+ \beta_{11} \text{ Size} + \beta_{12} \text{ MB} + \beta_{13} \text{ Government} + \beta_{14} \text{ MC}_{\text{GDP}} \\ &+ i. \text{Industry} \end{aligned}$ 

 $CAR [0 + 1] = \beta_0 + \beta_1 \text{Royal} + \beta_2 \text{Direct} + \beta_4 \text{Royal} * \text{Direct} + \beta_5 \text{Non}$ - Royal Politician +  $B_6 \text{Non}$  - Royal Politician \* Direct +  $B_7 \text{ Momentum} + \beta_8 \text{ NI} + \beta_9 \text{ BoardSize} + \beta_{10} \text{ Leverage}$ +  $\beta_{11} \text{Size} + \beta_{12} \text{ MB} + \beta_{13} \text{ Government} + \beta_{14} \text{ MC}_{GDP}$ + *i. Industry* 

CAR[-1+0+1]

 $= \beta_0 + \beta_1 \text{Royal} + \beta_2 \text{Direct} + \beta_4 \text{Royal} * \text{Direct} + \beta_5 \text{Non}$ - Royal Politician +  $B_6 \text{Non}$  - Royal Politician \* Direct +  $B_7 \text{ Momentum} + \beta_8 \text{ NI} + \beta_9 \text{ BoardSize} + \beta_{10} \text{ Leverage}$ +  $\beta_{11} \text{ Size} + \beta_{12} \text{ MB} + \beta_{13} \text{ Government} + \beta_{14} \text{ MC}_{GDP}$ + *i. Industry* 

5.3 Variables of the regression model

# 5.3.1 Dependent variables

The dependent variables in my regression model are *CAR0*, which is the abnormal return for the day of the event, *CAR* [0 +1], which is the abnormal return for the day of the event and the following day, and *CAR* [-1+0+1], which is the abnormal return for the day of the event and the days prior to and following the event day.

Similar to McWilliams and Siegel (1997), the *CAR0*, CAR01, and CAR101 are used and calculated by summing abnormal returns and the abnormal returns (actual return minus expected return) for the period for each one period:

 $CAR0 = \Sigma AR [0]$   $CAR [0 + 1] = \Sigma AR [0, + 1]$  $CAR [-1+0+1] = \Sigma AR [-1+0+1]$ 

#### 5.3.2 Independent variables

#### 5.3.2.1 Political connection variable

In this study, consistent with Faccio et al. (2006) and Faccio (2010), firms are considered to be politically connected when at least one politician (e.g., an MP, minister, head of state, or someone closely related to a top official) sits on the board of directors. Because the GCC countries are governed by royal families, a firm is also considered politically connected if one member of the royal family sits on the board of directors.

The characteristics of political connections differ among politicians, affecting their degree of power and authority. Firms connected with a royal family member are expected to have greater access to resources than firms connected with non-royal politicians. Therefore, two different political connection variables were used in the study. Firms were considered to be connected with royal families, when at least one member of the royal family sat on the board of directors, and non-royal politician connected when no royal family member sat on the board of directors and at least one non-royal politician (e.g., an MP, minister, or head of state) sat on the board of directors.

#### 5.3.2.2 Country level of crisis involvement variable

A direct involvement is a dummy variable, which takes 1 to refer direct country involvement in the political crisis (in this case Saudi Arabia, Bahrain, the UAE, and Qatar) and 0 to refer indirect country involvement (in this case Kuwait and Oman).

#### 5.3.3 Control variables

The model contains a number of control variables in relation to market returns. Momentum was used to control for information available to the market, which can affect the stock market return (calculated as the compounded daily market-adjusted return in the period from 90 days to 1 day prior to the event (Charitou et al., 2018). The NI variable was used to control for firms' profitability (calculated as net earnings divided by the market value of equity) (Bona-Sánchez et al., 2014), and the data were obtained from Datastream. The Board Size variable was used to control for board cohesiveness and as a proxy for describing the governance structure, which may influence firms' performance (Barnhart and Rosenstein, 1998; Yermack, 1996); these data were obtained from the Bloomberg database. The Board Size variable is the natural logarithm of the total number of directors who sits on the board. Leverage was used to control for the leverage effect (the total debt divided by total assets) and the data obtained from Datastream. Firm Size was used to control for the firms' size (calculated as the natural logarithm of the market value of equity) (Bona-Sánchez et al., 2014) and the data obtained from Datastream. The firm size is considered one of the variables that is related to firm market return (Charitou et al., 2018). For instance, prior studies found that small firms have generally earned higher returns than large firms and analysts recommend small firms more than large firms (Jegadeesh et al., 2004; Banz, 1981). The market-to-book ratio (MB) was used to control for firms' growth opportunities (Charitou et al., 2018) and the data obtained from Datastream. The *Government* variable represents the percentage of government ownership in the company obtained from the Bloomberg database. It has been included in the model, as it has been argued that government ownership negatively affects performance because the government prioritises social and political policy goals over profitability

(Sun et al., 2002). Since the sample companies are listed in six different countries, the MC GDP variable (the country's market capitalisation deflated by GDP was used to control for the importance of the capital market (Charitou et al., 2018), and the data were obtained from the Bloomberg database. Finally, industry dummies were included, denoted by *Industry*, to capture the industry-specific effect, since the listed firms in the sample operate in different industries, making them subject to different levels of competition and regulation and leading to different opportunities to earn profit (Opper et al., 2002; Chang and Wong, 2004; Wong et al., 2004). Industry was measured with a set of dummy variables which is: Industry-utility which takes value of 1 if the company operate in the utility industry and 0 otherwise. Industry-Industrial which takes value of 1 if the company operate in the industrial industry and 0 otherwise. Industry-Transportation which takes value of 1 if the company operate in the transportation industry and 0 otherwise. Industry-Bank which takes value of 1 if the company operate in the Bank/Savings & Loan industry and 0 otherwise. Industry-Insurance which takes value of 1 if the company operate in the insurance industry and 0 otherwise. Industry-others which takes value of 1 for the other companies and 0 otherwise.

# 6 Empirical results

# 6.1 Descriptive statistics

Table 1 Descriptive Statistics												
Variable	Obs	Mean	Std. Dev.	Min	Max							
CARO	583	-0.01	0.03	-0.17	0.21							
CAR01	583	-0.01	0.03	-0.25	0.22							
CAR101	583	-0.01	0.04	-0.24	0.37							
Momentum	583	-0.05	0.16	-0.91	1.49							
NI	583	0.01	0.30	-5.41	1.15							
BoardSize	583	1.99	0.26	1.10	2.64							
leverage	583	0.46	0.26	0.00	0.96							
Size	583	5.37	1.86	-0.65	11.10							
MB	583	1.45	1.30	0.06	11.90							
Government	583	0.12	0.23	0.00	0.98							
MC_GDP	583	0.65	0.17	0.35	1.02							

Table 1 presents descriptive statistics for the dependent variables and control variables in the model. The sample consists of 583 listed firms. The table shows that the market has a negative mean for *CAR0*, *CAR* [0 + 1], and *CAR* [-1 + 0 + 1], indicating that the market responds negatively to the occurrence of the political crises. The mean *Momentum is* -0.0539273, indicating that on average the stock price for the firms on the sample has been decreased in the period from 90 days to 1 day prior to the event. The *NI* mean is 0.0141418, indicating that on average the firms on the sample have positive profitability. The mean leverage of the sample is 0.4565794, while the mean Government ownership is 0.1153854.

#### 6.2 Univariate analysis

	Table 2 The abnormal return on each day from 10 days prior to the event day until 10 days after the event for each group												
			Politically connected		Royal politically		Non-Royal politically						
Event day	All Companies	P-value	firms	P-value	connected firms	P-Value	connected firms	P-Value	Non-Connected	P-value			
-10	-0.004	0.001	-0.003	0.196	-0.003	0.294	-0.002	0.215	-0.005	0.001			
-9	-0.002	0.021	0.000	0.868	0.001	0.667	-0.003	0.472	-0.003	0.008			
-8	-0.004	0.005	-0.006	0.008	-0.004	0.028	-0.009	0.088	-0.003	0.088			
-7	-0.002	0.055	0.000	0.864	-0.001	0.454	0.002	0.691	-0.003	0.039			
-6	-0.009	0.000	-0.005	0.001	-0.005	0.026	-0.006	0.007	-0.011	0.000			
-5	0.009	0.000	0.006	0.028	0.003	0.250	0.010	0.053	0.010	0.000			
-4	0.000	0.645	-0.001	0.239	-0.001	0.644	-0.002	0.061	0.000	0.969			
-3	-0.001	0.555	0.000	0.816	0.002	0.186	-0.005	0.197	-0.001	0.581			
-2	0.002	0.412	0.008	0.115	0.002	0.495	0.019	0.156	-0.001	0.332			
-1	0.003	0.007	0.000	0.870	0.001	0.731	0.000	0.819	0.004	0.004			
0	-0.009	0.000	-0.013	0.000	-0.018	0.000	-0.002	0.536	-0.007	0.000			
1	-0.002	0.034	-0.005	0.011	-0.005	0.020	-0.005	0.199	-0.001	0.458			
2	-0.001	0.480	-0.002	0.518	0.000	0.983	-0.005	0.432	-0.001	0.707			
3	0.000	0.788	0.002	0.326	0.006	0.011	-0.005	0.299	-0.001	0.277			
4	-0.005	0.000	-0.002	0.457	-0.005	0.015	0.004	0.397	-0.006	0.000			
5	0.004	0.006	0.006	0.001	0.009	0.001	0.001	0.496	0.002	0.164			
6	0.002	0.093	0.000	0.920	0.000	0.916	0.000	0.990	0.003	0.058			
7	0.000	0.855	0.004	0.355	0.001	0.665	0.008	0.415	-0.002	0.239			
8	-0.001	0.374	0.000	0.861	0.001	0.678	-0.003	0.246	-0.002	0.363			
9	0.000	0.857	0.002	0.350	0.001	0.638	0.004	0.417	-0.001	0.731			
10	-0.004	0.003	-0.005	0.003	-0.004	0.031	-0.008	0.045	-0.004	0.047			

The data in Table 2 show the abnormal return on each day from 10 days prior to the event day until 10 days after the event for four groups, along with the significant level (p-value), the group are in the following sequence: all companies, politically connected firms, royal politically connected firms, non-royal politically connected firms, and non-connected firms. Overall the event had a negative impact, as the mean of the abnormal return for all the firms on the event day was negative and statistically significant, indicating that the political crisis had an overall negative impact on regional markets. What stands out in the table is that the negative mean abnormal return for firms with royal connections on the event day is more than double the mean abnormal return for the total sample and it is statistically significant, indicating that royal-connected firms were more negatively affected by the event. This result supports Hypothesis 1b, as it is expected in the event of a political crisis, companies with royal family member ties will be more affected than others in regard to stock market performance. This expectation of the strong negative impact on royal connected firms is based on the expected loss of influence and power that has been obtained through associations with royal family members and that the occurrence of this political crisis puts this influence and power in doubt in terms of continuation. In addition, the table shows that the mean abnormal return for non-royal politically connected firms is not statistically significant. The results support the second hypothesis and provide evidence that, in the event of a political crisis in a monarchy context, firms that are particularly threatened with the loss of vital connections and networks are the companies with royal bonds, which show a statistically negative significant impact due the political crisis. Furthermore, the table shows that the negative impact on the firms is lower than the total sample and much lower than the negative impact on the firms connected with royal families. This supports what was expected of Hypotheses 1a and 1b, which is expected that politically connected firms.

involved countries									
Event day	Direct	P-Value	Indirect	P-Value					
-10	-0.004	0.000	-0.004	0.068					
-9	-0.005	0.000	0.000	0.995					
-8	-0.004	0.000	-0.004	0.144					
-7	-0.003	0.012	-0.002	0.424					
-6	-0.017	0.000	-0.001	0.641					
-5	0.009	0.000	0.008	0.044					
-4	0.000	0.856	-0.001	0.672					
-3	0.002	0.085	-0.003	0.102					
-2	-0.001	0.590	0.004	0.315					
-1	0.006	0.000	-0.001	0.514					
0	-0.015	0.000	-0.001	0.396					
1	-0.004	0.000	0.000	0.802					
2	0.000	0.801	-0.002	0.380					
3	0.001	0.270	-0.002	0.349					
4	-0.009	0.000	0.000	0.901					
5	0.006	0.000	0.001	0.715					
6	0.003	0.001	0.000	0.922					
7	-0.001	0.447	0.000	0.994					
8	-0.003	0.003	0.001	0.737					
9	-0.002	0.064	0.003	0.226					
10	-0.008	0.000	0.000	0.861					

Table 3 shows the abnormal return for the firms listed on the stock exchanges of the directly involved countries and the abnormal return for the firms listed on those of the indirectly involved countries for the same period. Interestingly, the results show that the companies listed on the stock exchanges of the directly involved countries witnessed high negative impact on the event day and the results were statistically significant, while the firms listed on the stock exchanges of indirectly involved countries did not show statistically significant results, indicating that the companies operating in countries that were only indirectly involved in the crisis did not face statistically significant negative stock market reaction. This result is expected as stock market participation changes their valuations based on political actions (Li and Born, 2006).

	Table 4											
The abnormal return	The abnormal return on each day from 10 days prior to the event day until 10 days after the event for Politically connected firms and Non-Connected frims											
Event day	Average Abno	Dyrahua										
	Politically connected firms	Non-Connected	P-value									
-10	-0.003	-0.005	0.430									
-9	0.000	-0.003	0.171									
-8	-0.006	-0.003	0.318									
-7	0.000	-0.003	0.254									
-6	-0.005	-0.011	0.022									
-5	0.006	0.010	0.262									
-4	-0.001	0.000	0.548									
-3	0.000	-0.001	0.896									
-2	0.008	-0.001	0.020									
-1	0.000	0.004	0.088									
0	-0.013	-0.007	0.020									
1	-0.005	-0.001	0.066									
2	-0.002	-0.001	0.670									
3	0.002	-0.001	0.143									
4	-0.002	-0.006	0.107									
5	0.006	0.002	0.160									
6	0.000	0.003	0.302									
7	0.004	-0.002	0.126									
8	0.000	-0.002	0.667									
9	0.002	-0.001	0.366									
10	-0.005	-0.004	0.639									

Table 4 compares the abnormal return for politically connected firms with that for non-connected ones. The table shows that the level of the negative impact for politically connected firms is much higher than the negative impact for nonconnected firms, and the difference is statistically significant, supporting Hypotheses 1a. The p-value is the significant level of the difference between the two groups.

Table 5										
The abnormal return on	The abnormal return on each day from 10 days prior to the event day until 10 days after the event for Royal politically connected firms and Non-Connected frims									
Event day	Average Abnormal Return									
	Royal politically connected firms	Non-Connected	P-value							
-10	-0.003	-0.005	0.657							
-9	0.001	-0.003	0.100							
-8	-0.004	-0.003	0.689							
-7	-0.001	-0.003	0.512							
-6	-0.005	-0.011	0.039							
-5	0.003	0.010	0.161							
-4	-0.001	0.000	0.793							
-3	0.002	-0.001	0.248							
-2	0.002	-0.001	0.270							
-1	0.001	0.004	0.206							
0	-0.018	-0.007	0.000							
1	-0.005	-0.001	0.109							
2	0.000	-0.001	0.840							
3	0.006	-0.001	0.007							
4	-0.005	-0.006	0.774							
5	0.009	0.002	0.052							
6	0.000	0.003	0.411							
7	0.001	-0.002	0.373							
8	0.001	-0.002	0.442							
9	0.001	-0.001	0.637							
10	-0.004	-0.004	0.944							

Table 5 compares the abnormal return for firms with royal connections with that for non-connected ones. The table shows that the level of the negative impact for royal-connected firms is more than twice the negative impact for non-connected firms, and the difference is statistically significant, supporting Hypotheses 1b and 2.

The p-value is the significant level of the difference between the two groups.

The abnormal return on	Table 6         The abnormal return on each day from 10 days prior to the event day until 10 days after the event for Non-Royal										
	politically connected firms and	Non-Connected firms	1								
Event day	Average Abnormal	P-value									
	Non-Royal politically connected firms	Non-Connected									
-10	-0.002	-0.005	0.384								
-9	-0.003	-0.003	0.801								
-8	-0.009	-0.003	0.215								
-7	0.002	-0.003	0.257								
-6	-0.006	-0.011	0.218								
-5	0.010	0.010	0.948								
-4	-0.002	0.000	0.486								
-3	-0.005	-0.001	0.205								
-2	0.019	-0.001	0.002								
-1	0.000	0.004	0.199								
0	-0.002	-0.007	0.161								
1	-0.005	-0.001	0.219								
2	-0.005	-0.001	0.310								
3	-0.005	-0.001	0.383								
4	0.004	-0.006	0.011								
5	0.001	0.002	0.800								
6	0.000	0.003	0.464								
7	0.008	-0.002	0.085								
8	-0.003	-0.002	0.748								
9	0.004	-0.001	0.324								
10	-0.008	-0.004	0.469								

Table 6 compares the abnormal return for the non-royal politically connected firms with the non-connected firms. The results show that the difference in the mean of the abnormal return for the two groups is not statistically significant. The p-value is the significant level of the difference between the two groups.

Table 7											
The abnormal return on politically	The abnormal return on each day from 10 days prior to the event day until 10 days after the event for Royal politically connected firms and Non-Connected firms in direct involved countries										
Event day	Average Abnormal Return for Direct										
	Royal politically connected firms	Non-Connected	P-value								
-10	-0.001	-0.006	0.025								
-9	-0.003	-0.007	0.009								
-8	-0.004	-0.004	0.971								
-7	-0.003	-0.003	0.843								
-6	-0.005	-0.023	0.000								
-5	0.005	0.012	0.001								
-4	-0.001	0.001	0.222								
-3	0.001	0.002	0.740								
-2	0.000	-0.001	0.521								
-1	0.003	0.007	0.059								
0	-0.027	-0.011	0.000								
1	-0.006	-0.003	0.074								
2	-0.001	0.001	0.290								
3	0.011	-0.002	0.000								
4	-0.006	-0.011	0.038								
5	0.010	0.005	0.071								
6	0.004	0.004	0.960								
7	0.000	-0.001	0.568								
8	0.000	-0.004	0.106								
9	0.000	-0.002	0.394								
10	-0.004	-0.010	0.013								

Table 7 compares the abnormal return for the royal-connected firms with the non-connected firms for the directly involved countries. The table shows that the level of the mean negative impact for the royal-connected firms is more than twice of that for non-connected firms, and this difference is statistically significant, supporting Hypotheses 1b and 3b. The p-value is the significant level of the difference between the two groups.

The abnormal return or R	The abnormal return on each day from 10 days prior to the event day until 10 days after the event for Royal politically connected firms and Non-Connected frims										
Event day	Average Abn	Average Abnormal Return									
	Direct	Indirect	P-value								
-10	-0.004	-0.004	0.945								
-9	-0.005	0.000	0.028								
-8	-0.004	-0.004	0.975								
-7	-0.003	-0.002	0.662								
-6	-0.017	-0.001	0.000								
-5	0.009	0.008	0.811								
-4	0.000	-0.001	0.743								
-3	0.002	-0.003	0.022								
-2	-0.001	0.004	0.250								
-1	0.006	-0.001	0.000								
0	-0.015	-0.001	0.000								
1	-0.004	0.000	0.112								
2	0.000	-0.002	0.349								
3	0.001	-0.002	0.170								
4	-0.009	0.000	0.000								
5	0.006	0.001	0.048								
6	0.003	0.000	0.149								
7	-0.001	0.000	0.873								
8	-0.003	0.001	0.142								
9	-0.002	0.003	0.050								
10	-0.008	0.000	0.011								

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Table 8 compares the abnormal return for the firms, listed on the stock exchanges of directly involved countries with that for firms listed on the stock exchanges of indirectly involved countries. The table shows that the level of the mean negative impact for the firms listed on the stock exchanges of directly involved countries is more than 10 times the negative mean for the firms listed on the stock exchanges of countries that had indirect involvement in the political crisis, and this

### difference is statistically significant. The p-value is the significant level of the

difference between the two groups.

lable 9														
Correlation matrix														
	CARO	Car01	Car101	Politically connected firms	Royal politically connected firms	Non-Royal politically connected firms	Momentum	NI	BoardSize	leverage	Size	МВ	Government	MC_GDP
CARO	1													
Car01	0.72 0.00	1												
Car101	0.60 0.00	0.83 0.00	1											
Politically connected firms	-0.09 0.02	-0.13 0.00	-0.15 0.00	1										
Royal politically connected firms	-0.17 0.00	-0.17 0.00	-0.17 0.00	0.7465 0.00	1									
Non-Roval politically connected firms	0.08	0.04	0.01	0.52	-0.18	1								
	0.04	0.37	0.89	0.00	0.00									
Momentum	0.09	0.01	0.05	0.04	0.02	0.03	1							
	0.03	0.90	0.26	0.34	0.61	0.45								
NI	-0.02	0.01	0.04	0.08	0.06	0.04	-0.12	1						
	0.68	0.73	0.33	0.05	0.12	0.37	0.00							
BoardSize	-0.16	-0.07	-0.03	0.21	0.14	0.13	0.01	0.14	1					
	0.00	0.09	0.52	0.00	0.00	0.00	0.87	0.00						
leverage	0.00	0.01	0.00	0.06	0.02	0.07	0.09	-0.05	0.27	1				
	0.98	0.82	0.93	0.12	0.67	0.08	0.04	0.22	0.00					
Size	-0.16	-0.11	-0.08	0.25	0.20	0.11	0.04	0.17	0.48	0.30	1			
	0.00	0.01	0.04	0.00	0.00	0.01	0.35	0.00	0.00	0.00				
мв	-0.04	-0.03	0.03	0.00	0.04	-0.05	0.07	0.01	0.08	0.07	0.26	1		
	0.31	0.54	0.42	0.95	0.32	0.23	0.07	0.81	0.05	0.07	0.00			
Government	-0.06	-0.02	-0.03	0.21	0.12	0.17	0.04	0.02	0.28	0.14	0.41	-0.03	1	
	0.15	0.67	0.40	0.00	0.00	0.00	0.39	0.71	0.00	0.00	0.00	0.44		
MC_GDP	-0.36	-0.36	-0.27	0.14	0.26	-0.12	-0.08	0.00	0.08	-0.03 0.41	0.38	0.04	0.09	1
	0.00	0.00	0.00	0.00	0.00	0.00	0.05	0.35	0.05	0.71	0.00	0.33	0.02	

Table 9 reports the correlations among the variables in all the models and suggests that multicollinearity does not affect subsequent regressions, although a formal test was conducted to ensure that multicollinearity would not be present in the regressions. The variance inflation factor (VIF) was calculated for each independent variable included in the model. The highest VIF for the models was well below 5 (the threshold value indicating that multicollinearity might be present (Studenmund, 1997)). Thus, the analysis indicates that multicollinearity is not a problem in the sample.

#### 6.3 Multivariate analysis

According to the RDT, firms' board members provide their firms with important resources, such as political connections, information, skills, legitimacy and know-how for dealing with bureaucracies (Pfeffer and Salancik, 1978; Boyd, 1990; Hillman and Dalziel, 2003; Goldman et al., 2008). In the same line, politicians are considered to be important influential actors in the firm environment due to their ability to secure vital resources for firms through their high social power. Therefore, firms are motivated to offer politicians a seat on their boards to acquire protection and access to key resources. However, investors and traders doubt about the possibility of political patronage continuing as a source of influence and power are expected to be reflected negatively on firms' performance in the stock exchange. The events that put the power of firms' political patronage under risk are expected to affect the connected firms negatively, as the influence that has been provided by that politician may not continue, leading to deterioration in the company's activities and performance. For instance, Fisman (2001) conducted a study that focused on the news about former Indonesian president Suharto's deteriorating health and the reactions of the firms listed on the Jakarta Stock Exchange that were connected to him. The study found that politically connected firms were more negatively affected than limited-bond firms, indicating that investors valued resources obtained through political connections and feared the risk of losing these resources.

In this study, the results are in line with the RDT and prior study evidence – they show that the negative effect for royal-connected firms due to the GCC political crises is greater than non-connected firms. The results of the study presented in Tables 10 and 11 show that royal-connected firms listed in directly involved countries suffered a more negative shock than others due to the political crises that occurred in

the GCC countries. The results in Table 11 show that the coefficient of royalconnected firms listed in directly involved countries had statistically significant results at the 1% level, but there were no statistically significant results for the effect of non-royal-connected firms, which supports Hypotheses 2 and 3b. In addition, these results highlighted the fact that companies with royal connections were vulnerable to resource uncertainty as a result of their royal relationship. Furthermore, the results show the uniqueness of the GCC context, where all the countries have monarchical systems that wield near-absolute power. Firms' associations with non-royal politicians had no statistically significant impact from the crises, indicating that investors did not value this type of connection in a monarchical context. The results are also in line with the first and second studies' findings – that no non-royal politicians had a statistically significant impact on their connected firms' performance or capital structure, which further supports Hypothesis 2. It also indicates that nonroyal politicians are not the source of power affecting firms' businesses in monarchy contexts.

Table 10											
Effect of political crises on politically connected firms											
Variable	Variable CARO CARO1 CAR101										
Politically connected firms	0.006	-0.003	-0.007								
Direct	-0.002	-0.010**	-0.004								
Politically connected firms*Direct	-0.014***	-0.008	-0.007								
Momentum	0.012	-0.001	0.013								
NI	-0.001	0.002	0.007								
BoardSize	-0.013***	-0.002	0.002								
leverage	-0.002	-0.008	-0.013*								
Size	0.001	0.002*	0.001								
МВ	0	0	0.002								
Government	0.002	0.005	0.003								
MC_GDP	-0.054***	-0.069***	-0.061***								
Constant	0.048***	0.034**	0.027*								
Industry Fixed Effect	Yes	Yes	Yes								
Ν	583	583	583								
r2	0.189	0.202	0.119								
interaction t	echnique with robust standard	errors. legend: * p<.1; ** p<.05; '	*** p<.01								

Table 11										
Effect of political crises on politically connected firms										
Distinguishing between being connected to a royal family member and non-royal politician										
Variable CARO CARO1 CAR101										
Royal politically connected firms	0.006	0.001	-0.003							
Direct	-0.002	-0.010**	-0.004							
Royal politically connected firms*Direct	-0.017***	-0.015***	-0.016**							
Non-Royal politically connected firms	0.006	-0.006	-0.012							
Non-Royal politically connected firms *Direct	-0.005	0.006	0.011							
Momentum	0.012	0.000	0.014							
NI	0.000	0.002	0.007*							
BoardSize	-0.013***	-0.002	0.002							
leverage	-0.003	-0.009	-0.014*							
Size	0.001	0.002*	0.001							
MB	0.000	0.000	0.002							
Government	0.001	0.004	0.000							
MC_GDP	-0.051***	-0.067***	-0.058***							
Constant	0.047***	0.033**	0.026*							
Industry Fixed Effect	Yes	Yes	Yes							
Ν	583	583	583							
r2 0.197 0.209 0.129										
interaction technique wi	th robust standard errors . I	egend: * p<.1; ** p<.05; ***	p<.01							

6.4 Robustness tests

In order to test the robustness of the results, Tables 12 and 13 show that the results, when using ordinary least squares with a sub-sample technique with robust standard errors, illustrated that royal-connected firms in directly involved countries show statistically significant negative coefficient, while royal-connected firms in indirectly involved firms did not show statistically significant results. Furthermore, controlling for country effect, Tables 14 and 15 show ordinary least squares with fixed country effect and robust standard errors, with results that were found to be consistent. Furthermore, although there were few cases of the presence of both a royal family member and non-royal family politician on the same board of directors, with this scenario found in only six firms in the sample, the study applied the ordinary least squares regression in the sample after excluding those firms, and the results held (see Tables 16 and 17).

Table 12												
Effect of political crises on politically connected firms												
A sub-sample technique, with reduct standard errors Ear All Sample Ear Direct Involved Countries Ear Indirect Involved Countries												
Variable	CARO		CAD101	CARO		CAD101			CAD101			
	CARU	CARUI	CAR101	CARU	CARUI	CAR101	CARU	CARUI	CARIUI			
Politically connected firms	-0.001	-0.00/**	-0.011***	-0.004*	-0.00/**	-0.010***	0.008*	0	-0.004			
Momentum	0.01	-0.001	0.012	0.008	0.017	-0.001	0.013	-0.008	0.019			
NI	-0.001	0.002	0.007	0.003	0.006*	0.011***	0.004	0.005	0.012			
BoardSize	-0.017***	-0.009*	-0.001	-0.006	0.001	0.013	-0.011	0.006	0.004			
leverage	-0.002	-0.007	-0.013*	-0.004	-0.012	-0.01	0.004	0.003	-0.009			
Size	0.001	0.002	0.001	0.003***	0.004***	0.003*	0	-0.001	-0.001			
MB	-0.001	0	0.001	-0.001	-0.001	0.002	0.002	0.003*	0.003			
Government	0	0.003	0.001	0.009*	0.011	0.009	0.003	0.011	0.01			
MC_GDP	-0.063***	-0.082***	-0.068***	-0.119***	-0.147***	-0.146***	-0.014	-0.015	-0.008			
Constant	0.061***	0.054***	0.038**	0.068***	0.066***	0.043*	0.025	-0.01	-0.001			
Industry Fixed Effect	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes			
Ν	583	583	583	308	308	308	275	275	275			
r2	0.171	0.182	0.115	0.447	0.407	0.357	0.048	0.046	0.033			
		legend: * p<.1	; ** p<.05; **	* p<.01								

#### Table 13

#### Effect of political crises on politically connected firms

#### Distinguishing between being connected to a royal family member and non-royal politician

	-								
A sub-sample technique with robust standard errors	For All Sample		For Direct Involved Countries			For Indirect Involved Countries			
Variable	CARO	CAR01	CAR101	CARO	CAR01	CAR101	CARO	CAR01	CAR101
Royal politically connected firms	-0.004	-0.009***	-0.014***	-0.005*	-0.008**	-0.011***	0.007	0.001	-0.002
Non-Royal politically connected firms	0.004	-0.003	-0.006	-0.002	-0.005	-0.006	0.01	-0.001	-0.007
Momentum	0.010	-0.001	0.013	0.009	0.017	0.000	0.012	-0.008	0.02
NI	-0.001	0.002	0.007*	0.003	0.006*	0.011***	0.004	0.005	0.012
BoardSize	-0.017***	-0.009*	-0.001	-0.006	0.001	0.013	-0.012	0.006	0.004
leverage	-0.003	-0.007	-0.013*	-0.005	-0.012	-0.011	0.004	0.003	-0.009
Size	0.001	0.001	0.001	0.002***	0.004***	0.003*	0	-0.001	-0.001
MB	0.000	0.000	0.002	-0.001	-0.001	0.002	0.002	0.003	0.003
Government	-0.001	0.003	0.000	0.009	0.011	0.007	0.003	0.011	0.01
MC_GDP	-0.060***	-0.079***	-0.065***	-0.117***	-0.145***	-0.142***	-0.013	-0.015	-0.009
Constant	0.059***	0.053***	0.036**	0.067***	0.066***	0.042*	0.024	-0.009	0
Industry Fixed Effect	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Ν	583	583	583	308	308	308	275	275	275
r2	0.178	0.185	0.117	0.448	0.408	0.359	0.048	0.046	0.034
legend: * p<.1; ** p<.05; *** p<.01									

Table 14           Effect of political crises on politically connected firms									
A sub-sample technique with robust standard errors and a fixed country effect For All Sample For Direct Involved Countries For Indirect Involved Countries							Countries		
Variable	CARO	CAR01	CAR101	CARO	CAR01	CAR101	CARO	CAR01	CAR101
Politically connected firms	0.002	-0.003	-0.006	-0.004*	-0.007**	-0.008**	0.008*	0	-0.004
Momentum	0.013	0.001	0.017	0.011	0.019	0.006	0.013	-0.008	0.019
NI	0.002	0.006**	0.010***	0.005**	0.007**	0.011***	0.004	0.005	0.012
BoardSize	-0.009**	0.003	0.006	-0.003	0.003	0.013	-0.011	0.006	0.004
leverage	-0.001	-0.005	-0.011	-0.004	-0.011	-0.011	0.004	0.003	-0.009
Size	0.001	0.002	0	0.002**	0.004**	0.003	0	-0.001	-0.001
МВ	0	0.001	0.002*	-0.001	-0.001	0.001	0.002	0.003*	0.003
Government	0.009**	0.014*	0.013*	0.009	0.011	0.01	0.003	0.011	0.01
Constant	0.008	-0.023*	-0.021	-0.007	-0.027	-0.047**	0.015	-0.02	-0.006
Industry Fixed Effect	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Country Fixed Effect	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Ν	583	583	583	308	308	308	275	275	275
r2	0.255	0.277	0.182	0.457	0.412	0.364	0.048	0.046	0.033
legend: * p<.1; ** p<.05; *** p<.01									

# Table 15 Effect of political crises on politically connected firms Distinguishing between being connected to a royal family member and non-royal politician

A sub-sample technique with robust standard errors and a fixed country effect		For All Samp	le	For Dire	ect Involved (	Countries	For Indire	ct Involved	d Countries
Variable	CARO	CAR01	CAR101	CARO	CAR01	CAR101	CARO	CAR01	CAR101
Royal politically connected firms	0.000	-0.003	-0.006**	-0.005*	-0.008*	-0.009**	0.007	0.001	-0.002
Non-Royal politically connected firms	0.006	-0.002	-0.005	-0.002	-0.005	-0.005	0.01	-0.001	-0.007
Momentum	0.013	0.001	0.017	0.011	0.019	0.006	0.012	-0.008	0.02
NI	0.003	0.006**	0.010***	0.005**	0.007**	0.011***	0.004	0.005	0.012
BoardSize	-0.009**	0.003	0.006	-0.003	0.003	0.013	-0.012	0.006	0.004
leverage	-0.001	-0.005	-0.011	-0.004	-0.012	-0.012	0.004	0.003	-0.009
Size	0.001	0.001	0.000	0.002**	0.004**	0.002	0	-0.001	-0.001
MB	0.000	0.001	0.002*	0.000	-0.001	0.001	0.002	0.003	0.003
Government	0.008*	0.014*	0.013*	0.008	0.010	0.009	0.003	0.011	0.01
Constant	0.009	-0.023*	-0.021	-0.007	-0.026	-0.046**	0.015	-0.02	-0.007
Industry Fixed Effect	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Country Fixed Effect	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
N	583	583	583	308	308	308	275	275	275
r2	0.257	0.277	0.182	0.458	0.413	0.365	0.048	0.046	0.034
legend: * p<.1; ** p<.05; *** p<.01									

Table 16						
Effect of political crises on politically connected firms						
Variable	CARO	CAR01	CAR101			
Politically connected firms	0.006	-0.002	-0.007			
Direct	-0.002	-0.010**	-0.004			
Politically connected firms*Direct	-0.014***	-0.008	-0.007			
Momentum	0.012	-0.001	0.013			
NI	-0.001	0.002	0.007			
BoardSize	-0.013***	-0.002	0.003			
leverage	-0.002	-0.008	-0.013*			
Size	0.001	0.002*	0.001			
MB	-0.001	0.000	0.001			
Government	0.002	0.005	0.002			
MC_GDP	-0.054***	-0.070***	-0.062***			
Constant	0.048***	0.034**	0.027*			
Industry Fixed Effect	Yes	Yes	Yes			
Ν	577	577	577			
r2	0.185	0.199	0.116			

interaction technique with robust standard errors after excluding firms with presence of both a royal family member and non-royal family politician in the same board of directors. legend: \* p<.1; \*\* p<.05; \*\*\* p<.01

#### Table 17

# Effect of political crises on politically connected firms

# Distinguishing between being connected to a royal family member and non-royal politician

Variable	CARO	CAR01	CAR101				
Royal politically connected firms	0.006	0.001	-0.003				
Direct	-0.002	-0.010**	-0.004				
Royal politically connected firms*Direct	-0.017***	-0.015***	-0.016**				
Non-Royal politically connected firms	0.006	-0.006	-0.012				
Non-Royal politically connected firms *Direct	-0.006	0.004	0.010				
Momentum	0.012	0.000	0.014				
NI	-0.001	0.002	0.007*				
BoardSize	-0.013***	-0.002	0.003				
leverage	-0.003	-0.009	-0.014*				
Size	0.001	0.002*	0.001				
МВ	0.000	0.000	0.002				
Government	0.001	0.003	0.000				
MC_GDP	-0.051***	-0.068***	-0.059***				
Constant	0.047***	0.033**	0.026*				
Industry Fixed Effect	Yes	Yes	Yes				
Ν	577	577	577				
r2	0.191	0.205	0.124				
interaction technique with robust standard errors, after excluding firms with presence of both a royal family member and non-royal family politician in the same board of directors. legend: * p<.1; ** p<.05; *** p<.01							

# 7 Conclusion

The aim of the present research was to examine the extent to which political uncertainty surrounding the royal family and politicians in the event of a political crisis had an impact on politically connected firms. The research found that the political crisis led to a negative effect on the stock market performance of firms with royal connections and this negative effect increased with the growing involvement of the country in the political crisis. According to the RDT, the board members are expected to provide their firms with access for vital resources (Pfeffer and Salancik, 2003). Furthermore, politicians are believed to have significant social power in the environments in which organisations operate (Pfeffer, 2010). Therefore, uncertainty about staying on power for politicians who hold seats on the boards of directors of companies is expected to be reflected negatively on their firms, as the resources and power obtained by them threaten continuity. For example, Fisman (2001) found that the returns of firms connected with the former President Suharto were considerably lower than the returns of less politically connected firms, when the president suffered from health issues, indicating investors' fear of losing the resources obtained as a result of Suharto's political power. The results of this research illustrate three main points. The first is that political crises among countries are reflected negatively on companies with political connection. Second, political connection with members of the royal family is valued by stock market participants and, in case of uncertainty about staying in power for the royal family, this would reflect negatively on the firms' stock market return, while for non-royal politicians, the results indicate that there is no statistically significant impact on the companies connected with them, demonstrating that, in a monarchy context, the source of influence and power is in the
hands of the royal family. Third, countries' direct or indirect involvement in political crises plays a key role in the level of the negative effect facing the listed companies in their stock market.

This study contributes to the existing knowledge of firms' political connection by providing, to the best of my knowledge, the first study to investigate the impact of political crises between countries on politically connected firms through stock market performance. Furthermore, this study presents an empirical investigation into different reactions to stock market participation towards companies connected with royal family members and non-royal politicians, by showing that, in a monarchy context, stock market participants appreciate the value of firm connection with the members of the royal family and recognise them as an important source of influence and power, they while do not consider connection with non-royal politicians as a source of power and influence. Furthermore, this study advanced our knowledge by investigating the impact of political uncertainty on politically connected firms. For example, Fisman (2001) and Li et al. (2018) conducted their studies in the republican systems, while this study took place in a monarchical system, which provides a broader scope for the definition of firms' political connection by recognising the importance of royal family as a source of power and influence. The study also deepens our understanding of the RDT, since previous studies focused on the effect of political connections on firms' performance and profitability but did not apply the theory to a case of political uncertainty.

A limitation of the study is that it did not include political connections through ownership, mainly because of the unavailability of relevant data. Furthermore, the study did not control for the level of business exposure for firms on directly involved in the crisis countries. Firms' business exposure is expected to

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affect the level of implication for their stock market performance during political crises. In addition, the study did not show the effect of having more than one politician on a firm's board of directors and how this affects the firm's stock market performance.

### Chapter 5: Conclusion

### 1 Introduction

This thesis includes three essays that study the effects of firms' political connections within a monarchical system. The first essay (Chapter 2) focuses on the effects of the firms' political connections on their performance. The second essay (Chapter 3) examines whether or not firms' political connections and/or religiosity affect capital structure. The third essay (Chapter 4) presents the first study to examine the stock market reaction towards politically connected firms during political crises. Specifically, this study examines whether or not political uncertainty would affect politically connected firms in the stock market. The main results along with their implications are summarised in the following sections.

#### 2 Firms' political connections and performance impact hypothesis

Chapter 2 tests the effect of firms' political connections on their performance in a monarchy context. It investigates whether being politically connected would enhance or undermine firms' performance. Additionally, the study investigates the difference between being connected with the royal family and being connected with non-royal politicians in the monarchy context. Prior studies have found mixed results between negative effects (Bertrand et al., 2007; Chaney et al., 2011; Abdul Wahab et al., 2015) and positive effects (Shin et al., 2018; Mian and Khwaja, 2004; Adhikari et al., 2006). Furthermore, most of the previous studies have analysed republican systems, and very few have studied monarchies. The few studies that focused on monarchies have not analysed in depth the roles of royal families but have focused on the roles played by ministers and MPs. Therefore, this study analyses data from six monarchical countries that form the GCC and distinguishes between being connected with royal and non-royal politicians, with a view to reaching a more thorough understanding of the effects of firms' political connections and enlightening prior studies' mixed results.

The results relating to the effects of firms' political connections on their performance in a monarchy context indicate that there is a difference between being connected with the royal family and being connected with non-royal politicians, as there is no statistically significant effect on firms' performance when they are connected with non-royal politicians. On the other hand, the results indicate statistically significant positive results when the firms are connected with royal family members. This finding indicates that, in a monarchy context, the power lies in the royal families' hands and operates as an element that may provide resources for firms with which the royal families are connected. The results stress the importance of knowing the type of ruling system when defining politically connected firms.

3 Firms' political connections capital structure hypothesis and religiosity hypothesis

Chapter 3 examines the effects of both political connections and firm religiosity on firms' capital structure. First, the chapter investigates whether politicians would enable firms to obtain more debts by providing access to credit or reflect the national culture of the study context and obtain a lower level of debts compared to non-connected firms. Second, the chapter examines the effect of a firms' religiosity on its capital structure, which, to the best of my knowledge, has not been tested empirically in any existing studies. The results indicate that being connected with non-royal politicians do not have any statistically significant results. These results support Chapter 2, which found that, in a monarchy context, non-royal politicians do not perceive power, which allows them to affect firms' performance. Additionally, the results show that the firms connected with the royal family have lower levels of debt than the nonconnected firms, which is explained by royal family members, reflecting undesirable debts regarding the national culture of this study context by maintaining lower levels of debt in royal-connected firms compared to non-connected firms. On the other hand, a firm's religiosity—classified as Islamic in this study—shows lower levels of debt compared to non-Islamic firms, which is explained by not encouraging Islamic religion on obtaining loans.

# 4 Market reaction towards politically connected firms during political crises

The political stability of firms' political patronage is a vital property of politically connected firms. Events that produce uncertainty regarding the political patronage's continuation of power is expected to negatively affect the firms with whom it has ties, as the resources obtained by the political patronage could be discontinued. Although studies have investigated the effect of political connection on firms' performance and dealings, studies have yet to investigate the effect of political crises on politically connected firms. Therefore, Chapter 4 was motivated to address this literature gap by using the political crises in the GCC, which occurred in June 2017 along with its effect on politically connected firms in this monarchy context.

By implementing event study methodology using market model methodology and market price data, this study found that non-royal politically connected firms

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were not statistically significantly affected by political crises; on the other hand, royal-connected firms showed statistically significant negative effects. Furthermore, this study found that as the level of the country involvement in the crises increases, the negative effect increases for the royal-connected firms. These results suggest that the stock market does appreciate the value of firms' royal connections, as it believes that royal connection is a source of power that enables the connected firms to secure resources. However, the stock market does not value connection with non-royal politicians in the monarchy context. These results support the findings in the first and second essays, which determine that a connection with non-royal politicians affects neither firms' performance nor their capital structure, suggesting that it is not a source of power in a monarchy context.

### 5 Future research

This research has raised many questions that merit further investigation. Studying firms' political connections through ownership can shed new light on the effects of firms' political connections. It would be interesting to see whether connection through ownership works in the same direction as connection through being on a board of directors. Another possible area for future research is to investigate the channels by which firms' political patronage enhance firms' performance. Exploring these channels would illustrate the mechanism behind firms' political patronage. In addition, it would be interesting to assess the effects of firms' political connections in other monarchies in East Asia and Europe. Also, further research should be undertaken to compare the effect of firms' political connections in both monarchies and republican forms of government. The results of the comparison would grant further understanding of the impact of firms' political connections in

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different ruling systems. In the future, it will be important to explore the potential effect of firms' political connections on their debt costs in monarchical contexts. Future studies could also explore the effects of firms' political connections on the terms of their debt contracts and collateral requirements. Future work could investigate the other effects of firms' religiosity, such as the effects on transparency, debts cost or performance Another possible area of future research would be to investigate the impact of political crises on companies in the long-term, exploring whether political connections could help firms to survive and maintain their levels of performance during crises.

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## Appendix

Table19 Descriptive Statistics for UAE					
Variable	Mean	Std. Dev.	Min	Max	
ROE	0.06	0.15	-1.20	0.51	
ROA	0.04	0.05	-0.22	0.23	
Government	0.12	0.18	0.00	0.70	
Leverage	0.38	0.21	0.04	0.99	
Size	1378463.00	4745713.00	24700.00	38100000.00	
Bord Size	8.18	1.98	5.00	13.00	
Age	24.08	12.62	1.00	43.00	

Table 20 Descriptive Statistics for Bahrain					
Variable	Mean	Std. Dev.	Min	Max	
ROE	0.08	0.09	-0.35	0.30	
ROA	0.06	0.07	-0.18	0.28	
Government	0.10	0.18	0.00	0.64	
Leverage	0.23	0.17	0.02	0.62	
Size	274490.40	559260.90	9760.00	3408750.00	
Bord Size	8.45	1.69	5.00	11.00	
Age	28.63	13.28	4.00	53.00	

Table 21 Descriptive Statistics for Saudi Arabia				
Variable	Mean	Std. Dev.	Min	Max
ROE	0.12	0.15	-0.78	0.60
ROA	0.07	0.09	-0.64	0.46
Government	0.09	0.18	0.00	0.85
Leverage	0.37	0.21	0.01	0.84
Size	2739531.00	8162359.00	58660.00	89200000.00
Bord Size	8.42	1.53	5.00	13.00
Age	23.76	13.10	1.00	60.00

Table 22 Descriptive Statistics for Kuwait					
Variable	Mean	Std. Dev.	Min	Max	
ROE	0.03	0.15	-1.04	0.57	
ROA	0.02	0.08	-0.49	0.34	
Government	0.03	0.09	0.00	0.61	
Leverage	0.38	0.22	0.00	0.91	
Size	353521.50	1273080.00	2470.00	23200000.00	
Bord Size	6.00	1.42	3.00	12.00	
Age	23.74	12.58	4.00	61.00	

Table 23 Descriptive Statistics for Oman					
Variable	Mean	Std. Dev.	Min	Max	
ROE	0.16	0.12	-0.33	0.48	
ROA	0.09	0.07	-0.14	0.29	
Government	0.12	0.19	0.00	0.70	
Leverage	0.46	0.21	0.03	0.93	
Size	334118.70	581000.70	2200.00	3311750.00	
Bord Size	7.71	1.63	5.00	12.00	
Age	20.86	9.20	6.00	40.00	

Table 24 Descriptive Statistics for Qatar					
Variable	Mean	Std. Dev.	Min	Max	
ROE	0.14	0.11	-0.10	0.64	
ROA	0.08	0.06	-0.07	0.25	
Government	0.21	0.22	0.00	0.74	
Leverage	0.38	0.23	0.01	0.95	
Size	3384377.00	5389986.00	26830.00	28100000.00	
Bord Size	8.41	1.69	5.00	12.00	
Age	18.16	15.05	2.00	58.00	