

## **The Impact of Ruling Family Board Members on the Performance of Commercial Banks**

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### **Abstract**

We examine the impact of royal family involvement in the ownership and strategic management of commercial banks within the Gulf Cooperation Council (GCC) region. Existing finance literature has examined the impact of board members with political connections on bank performance to find mixed evidence of whether such connections have a positive or negative impact. However, such empirical studies have not been applied to the commercial banks of the GCC region. Our empirical analysis uses four separate metrics of performance to examine what influence board membership, board chairmanship and bank ownership shares by a royal family member has on bank performance. Our panel data analysis of GCC commercial bank data across six countries from 2013 to 2018 reveals that all three potential royal family roles exert a positive influence over GCC commercial bank performance. We derive these empirical results using relevant control variables at both the firm level and the industry level. Furthermore, we apply a system generalized moments of methods specification to our sample and find that these results are invariant to various specification robustness checks. Our results appear to support the Resource Dependency Theory (RDT), where the commercial banks rely on external resources to enhance financial performance.

### **1. Introduction**

Globalization has increased the level of competition of all industries, including the financial sector of nearly nation's economy. Commercial banks seeking an external edge to enhance their financial performance often resort to populating their governing boards with a few politically connected members who can provide pertinent inside information and exploit their professional relationships to create new, lucrative financial opportunities. Yet empirical studies in the literature examining the efficacy of this strategy have been focused predominantly on Western economies and have produced mixed results. This raises some intriguing questions for commercial banks operating in the Gulf Cooperation Council (GCC) economies: Does having a royal family member on their governing board make a net positive impact? Would the impact be any different if that board role was Chairman of the Board? What if the royal member were a part owner of the bank?

What makes the question relevant is the fact that there are diverse cultural and political institutions that influence commercial banks across the West, and these economies enjoy a more diversified set of sources for their economic growth. The GCC countries

share a relatively homogeneous Islamic culture and political structure governed by their respective royal families. Further, the GCC are far more heavily dependent on a fossil fuel industry as their primary source of economic growth. It is therefore reasonable to empirically investigate whether including royal family members on the board is a reasonable strategy for GCC commercial banks.

However, predicting the impact of royal family membership, or even partial ownership, is less than clear. Each royal family seeks to optimize the nation's economy by balancing the financial interests of all industry sectors, sometimes at the expense of the financial sector. Also, royal families are not solely driven by economic outcomes, favoring political or cultural decisions that might enhance their reputation at the expense of economic efficiency. In other words, the interests of the royal family do not always converge with the interests of the financial sector, or even the specific commercial bank over which they have direct influence.

It is against this backdrop that we design our empirical analysis of the financial performance of the commercial banks operating in the GCC region. Our sample includes all commercial banks that have political directors regardless of their background, Islamic or conventional. We use panel data analysis of commercial bank data across six GCC countries from 2013 to 2018 while controlling for firm-specific and industry-specific control variables. Our results indicate that political connections among the GCC commercial bank boards have a positive impact on bank performance, as measured by return on equity (ROE), sales over total assets, Tobin's Q, and holding period return. These results support the Resource Dependency Theory (RDT), where the commercial banks are believed to rely on external resources to gain these aforementioned benefits. To ensure the robustness of our results, we apply a system generalized moments of methods (SGMM) specification to our sample to determine whether support exists for finding causality in this relationship and to control for potential endogeneity issues.

In what follows, section 2 reviews the related literature and section 3 describes the hypotheses development. Section 4 describes the data and the empirical methodology used for the analysis. Section 5 explores the impact the ruling family members on the banks' performance, and discusses the broader implications of the empirical findings. Section 6 provides a summary and conclusion.

## **2. Literature Review**

The globalization of financial institutions and the concurrent relaxation in governmental oversight of the financial services industry have combined to create an increasingly competitive environment among the commercial banks in emerging markets (Clarke, 2016; Srairi, 2010; Turk-Ariss, 2009; Al-Muharrami, et al., 2006; Casu and Girardone, 2009; Mester, 1996). To survive in this competition, many commercial banks are seeking external resources to improve their performance and enhance their market share by revising the composition of their governing boards. The majority of extant studies in the literature focus solely on banks in Western countries (Agoraki, et al., 2009; Baysinger and Butler, 1985; Bhagat and Black, 2002; Callen, et al., 2003; Ghosh,

2018; Mester, 1996; Rechner and Dalton, 1991; Siciliano, 1996; Tanna, et al., 2011; Tarawneh, 2006; Yermack, 1996). The conclusions of these studies have been mixed, with some finding a positive relationship between the number of political connections and banks' performance while others find a negative relationship (Chen, et al., 2014; Haselman, et al., 2018; Hung, et al., 2017; Jou, et al., 2017; Liang, et al., 2013).

These contradictory findings have been a source of confusion for the directors of commercial banks. This is especially true among those commercial banks in the Gulf Cooperation Council (GCC) region that face a greater degree of government involvement in their respective economies in general and a greater incidence of having ruling family members on their boards of directors. The literature often treats this type of political presence on the board of directors as being similar to the state-ownership of banks in other national economies (La Porta, et al., 2002; Sapienza, 2004; Dinç, 2005; Khwaja and Mian, 2005; De Nicolò and Loukoianova, 2007; Micco, et al., 2007).

### **2.1 The Political Environment in the GCC Countries**

The GCC countries are authoritarian states with hereditary rulers who are closely assisted by the inner circles of the ruling family members (Peterson, 2001). The current ruling families in the GCC countries are derived from powerful tribal leaders who once dominated the region. These powerful families are distinctive from the public by having special titles such as King, Prince, or Elder. In each country, the members of the ruling family control the ruler's office as well as his cabinet by being ministers and heads of highest positions in government. To maintain their control, the ruling families constitute a chain of command in the government to provide both intelligence and feedback to protect and preserve their political regimes. In addition, they maintain formal councils which provide forums for the discussion of different issues, such as settlement of disputes and the distribution of benefits. Nevertheless, these councils do not deal with central political matters or a ruler's succession.

On the other hand, the business communities in these regions have a long history of political influence, as local stability has been dependent on the relationship between the prominent tribal leaders (who became ruling families) and the local merchant families (goods suppliers and commodity traders) (Kamrava et al., 2016; Peterson, 2001). The ruling families found the synergy in sharing some decision-making power with local businesses as an indispensable source of liquid assets needed to sustain their political powers and maintain their countries' economies. In return, the merchant families historically received political protection, as well as reductions in taxes and customs duties (Kamrava et al., 2016; Peterson, 2001). The rising oil and gas revenues, coupled with recent independence from the British occupation, empowered the royal families across the GCC countries to control the region's economy. They did so by infusing their families' members into the leadership structures of different industries, such as oil and gas, real estate, manufacturing, and the financial sectors.

### **2.2 The Impact of Political Connections**

The political connections of bank board members around the world are manifested in various forms. Bank shareholders and officers can be a member of parliament, a

minister, or closely related to a top politician or party (Faccio, 2006; Dao, 2013). Banks with a high proportion of such board members might be seen as behaving similarly to state run banks (Baum et al., 2008). These political connections reduce the degree of uncertainty in projecting the future political and economic environment that is shaped by changing government policies, regulations and enforcement levels (Hillman, 2005; Lang & Lockhart, 1990). Baum et al., (2008) argues that political connections can assist the banks to overcome many obstacles and improve existing business conditions. Nevertheless, our study does not address these types of political connections but goes up to a higher level by examining the involvement of the ruling family in the commercial banks which is the highest authority in the GCC countries, similar to the Presidents' authority in other political regimes. This aspect makes our study distinctive and contribute to the limited literature on the impact of the ruling family members on the board of directors (Nasser, 2019).

But this raises the question: is it reasonable to assume that populating the boards of GCC commercial banks with royal family members will have the same impact as having politically connected board members directing state run banks in non-GCC countries? The GCC countries comprise Bahrain, Kuwait, Oman, Qatar, Kingdom of Saudi Arabia (KSA), and United Arab Emirates (UAE). If the GCC countries share a relatively homogenous culture, a common political structure, and a less diverse set of factors for creating economic growth than Western economies, this assumption should be called into question. Consider each of these institutional and economic issues in turn.

First, consider the impact of *cultural institutions*. The GCC economies all share a distinct Islamic, Arabic-speaking culture (Kantor, et al., 1995). GCC economies are not based on Western common laws but instead on Sharia laws and Islamic economic customs, which can have unique impacts on commercial banking (Rasli, et al., 2020). Notably, the economies of these countries, including the banking sectors, have all been influenced by the royal family members that direct governmental entities and exploit old trading relationships (Kshetri and Ajami, 2008). The second source of interest is based on *political institutions*. The political system and governmental structures are quite similar across GCC nations, where each country is ruled by a powerful, dynastic family that strongly influences its legal, economic, and political systems. Indeed, the commercial banks in the GCC countries play a critical role in stabilizing the provincial and relatively less mature financial markets (Abdelsalam et al., 2017). Third, consider the *source of economic growth*. Over the last five decades, the GCC region has created substantial financial wealth from leveraging their rich endowment of natural energy resources, creating income per capita and saving capacity akin to the wealthiest countries in the world. In turn, the banking sectors of these countries have flourished as savings from oil and natural gas discoveries were channeled into local banks (Mostafa, 2007).

Consequently, the ruling family members in GCC countries significantly influence their respective public and private institutions through a centralized decision-making process that ensures preferred outcomes weighted across all business operations (Hertog, 2012), which can occasionally have a negative impact the performance of the financial

sector (Abdelsalam, et al., 2017). Moreover, the ruling family members often use their connections to favor certain classes in the community (Amenta, 2000; Atiyah, 1992). Hence, the presence of the ruling family members in a commercial bank's board of directors may create many lucrative opportunities for those banks directly related to the elite of the community, which might positively enhance their performance (Ali, et al., 2007).

Accordingly, many GCC commercial banks appoint one or more members into their boards of directors from the ruling family to gain access to various privileges, such as access to greater deposits, lower taxes, relaxed regulatory monitoring, and preferential treatment in governmental contracts (Abdelsalam, et al., 2017; Disli, et al., 2013; Pfeffer and Salancik, 1978). This unique type of presence of political influence on the boards of GCC commercial banks, as well as their common cultural and political environments, makes our study unique. We provide empirical evidence to examine the relationship between the financial performance GCC commercial banks and royal family representation on their directing boards.

The association between characteristics of board members and firm's performance is well articulated by RDT, which examines the impact of the external management resources upon any organization's performance. Outside directors enhance business performance via additional networking and better access to resources (Tanna et al., 2011), fund generation and uncertainty reduction (Boyd, 1990; Guo, et al., 2014; Hillman, et al., 2009; Jackowicz, et al., 2013; Maaloul, et al., 2018; Pfeffer and Salancik, 1978). In fact, the RDT focuses on how political connections enable companies to gain governmental support to enhance their performance (McWilliams, et al., 2002; Su et al., 2014; Wu, et al., 2012). Specifically, Maaloul, et al., (2018) argue that having politically connected directors can have a significant effect on the firm's ability to obtain government favors that improve performance. Specific to the banking industry, RDT research has shown that greater diversity of board member characteristics can be associated with improved performance (Arnaboldi, et al., 2020). This includes outsider board members who are political or business experts (Abobakr and Elgiziry, 2017; Ogbaisi et al., 2019; Jahan and Van Peursem, 2021), formal representatives of Sharia Law (Alman, 2012; Hassan, et al., 2017; Khalil and Taktak, 2020) or raising issues relevant to women (Adeabah, et al., 2019; Isola, et al., 2020; Khalil and Chihi, 2020).

### **3. Hypotheses Development**

A mentioned earlier, the impact of political connections on firm's performance is grounded in the literature by Stigler (1971), who explained the benefits and limitations of state involvement in business strategy formulation and operational decision making. Subsequent studies examine politicians' impacts on banking performance and produce mixed results (Altunbas, et al., 2001; Boubakri, et al., 2012; Claessens, et al., 2008; Fisman, 2001; Goldman, et al., 2008; Johnson and Mitton, 2003; Molyneux and Thornton, 1992; Li, et al., 2008). Some studies argue that the presence of politicians on the board of directors does not enhance the firms' performance, as these firms tend to reduce managerial profit incentives and increase efforts at fulfilling political interests (Haris, et al., 2019; Yeh, et al., 2010), especially if the banks are government owned

(Poczter, 2017). This negative relation is found using data from Korea (Chiu and Joh, 2004), Pakistan (Khwaja and Mian, 2005), China (Kang, 2003), Solvenia (Domadenik, te al., 2016), and a cross section of multiple countries (Boubakri, et al., 2008).

Conversely, other studies find a positive influence from the political connections of board members (Braham, et al., 2019). Political connections can produce favorable outcomes, such as lowering the cost of equity and decreasing risk (Boubakri, et al., 2012) or adding value to the firms, and enhancing their performance (Fisman, 2001; Johnson and Mitton, 2003). This has been found using data from the U.S. (Richter, et al., 2009), Malaysia (Johnson and Mitton, 2003); Poon, et al., 2013), Indonesia (Fisman, 2001), Latvia (Dombrovsky, 2008); and Ukraine (Vynoslavska, et al., 2005). Claessens, et al. (2008) show that facilitating businesses' access to bank financing is an important channel through which political connections operate. Poon, et al. (2013) and Baum et al., 2008 argue that bank directors with political ties enrich the business conditions for both businesses and banks by permeating many political and regulatory barriers (). Further, politically connected banks can receive preferential treatment from the government in the form of cheaper sources of funding, favorable tax treatments and access to restricted licenses (Mohamad, et al., 2007; Niessen and Ruenzi, 2010). In this vein, Gomez and Jomo (1999) and Fraser, et al. (2006) find a positive and significant link between political connections and firms' leverage in Malaysia. This is noteworthy, as the Malaysian government exerts a significant influence over the corporate sector employing both listing restrictions and the direct control of the banking sector. This creates an environment similar to the political structure that exists in GCC countries.

On the bank funding side, Boubakri, et al. (2012) notes that investors require a lower cost of capital for politically connected firms, due to their low level of risk compared to non-connected firms. Infante and Piazza (2014) find evidence that politically connected firms benefit from lower interest rates, though only when the political connection is at a local level. This effect is generally stronger when politically connected firms borrow from banks with politicians on their boards, and when the degree of autonomy granted to local loan officers is higher.

Based on the balance of this literature, we assume the presence of the ruling family members serving on the boards of the commercial banks will have a positive impact on bank performance. This leads to the following hypothesis:

*H1: The presence of ruling family members in the board has positive impact on commercial banks' performance.*

Moreover, we expect the chairmanship of the board by a ruling family member brings even greater advantages to the banks, due to the relatively higher power and influence this position has over the board and the bank management (Haniffa and Cooke, 2005), which should translate into better financial performance (Saito, 2016). This leads to the following hypothesis:

*H2: Chairing the board of directors by ruling family members has positive impact on commercial banks' performance.*

Beyond the study of the composition of bank boards, other studies examine the different aspects of *ownership* structures on banks performance. This includes comparing family ownership, institutional ownership, and government ownership structures (Al-Musalli and Ismail, 2012; Arouri, et al., 2011). These studies also find inconclusive results as to whether ownership structure influences bank performance. Arouri, et al., (2014) report a positive impact on bank performance from family, foreign, and institutional ownership, but they find government ownership has no discernable impact on performance. Similarly, Naushad & Malik (2015) find that major shareholders in the ownership structure of GCC banks tend to have a positive impact on their performance. However, none of these studies examine whether the individual or family owner is a prominent political figure, such as a ruling family member (Ongore, 2011). As the ruling family members of the GCC countries are well known entrepreneurs and rich businessmen (Hillman, 2005), the ruling family members across the GCC region have founded many holding companies and are appointed to the boards of large financial institutions (Hillman, 2005; Kamrava, et al., 2016; Peterson, 2001). This representation has been welcomed by the commercial banks in the GCC countries, as they extract private benefits from this unique source of political power to improve their performance. This leads to the following hypothesis:

*H3: The ownership of commercial banks by ruling family members has positive impact on bank performance.*

#### **4. Data and Methodology**

The sample of this study consists of all the listed commercial banks of the six GCC member states: Bahrain, Kuwait, KSA, Oman, Qatar, and UAE. The list of all commercial banks is collected from the *BankFocus* (previously known as *BankScope*). Board data are manually collected. For example, board members who are royal family members are identified based on their last names that belong to selected royal families. Year-end financial data from each bank is gathered from two sources: *BankFocus* and *DataStream*. These two databases complement each other for the missing data. Data prior to 2013 does not disclose the identity of director clearly. So our sample period covers from 2013 to 2018.

**Table 1: Data statistics**

Panel A shows the number of observation across the filtering stages in concluding the final sample.

Panel B shows the sample distribution across 6 sample years and 6 GCC nations.

**Panel A: Sample selection.**

Number of observations from <i>Bankscope</i>	390
Less:	
Firms without banking operations	24
Firms with missing values in certain years	46
Total firm-year observation	320

**Panel B: Sample distribution based on country and year**

	Bahrain	KSA	Kuwait	Oman	Qatar	UAE
2013	11	9	10	8	9	17
2014	11	9	10	8	9	17
2015	11	9	10	8	9	17
2016	11	9	10	8	9	17
2017	11	9	10	8	9	17
2018	11	9	10	8	9	17

Panel A of Table 1 reveals that the sample initially consisted of 390 firm-year observations. We exclude firms without commercial banking operations (24 firm-years), and firms with missing values in certain years. The final sample has 320 firm-year observations. Another 46 observations were removed due to missing key values for performance criteria calculations. Out of these 46 observations, 42 observations come from the same seven banks across three countries, with 30 observations being connected with royal members. From this distribution, we see that the observations removed are random and not causing selection bias. Panel B of Table 1 shows the sample distribution across six countries and six sample years. It reveals how the UAE has the highest number of firm-year observations (85), followed by Bahrain (55) and Kuwait (50).

**Table2: Variable definitions**

<b>Variables</b>	<b>Definition</b>
<b><i>Bank performance variables</i></b>	
ROE	Return on equity.
SOA	Sales (Revenue) over total asset
TBQ	Tobin-Q as measured by total market value over total asset
HPR	Annual holding period return
<b><i>Proxies for royal family connection</i></b>	
RoyalDirector Ratio	Ratio of the number of ruling family directors over total number of board members.
RoyalChair	Dummy equals 1 if board chair is a royal family member, otherwise 0
RoyalOwnership	Share ownership of royal family
<b><i>Firm-level variables</i></b>	
LnAsset	Log of total asset
CashOverAsset	Ratio of free cash flow over total asset
FirmAge	Bank's age
HHI	The sum of the squared market shares of all banks in the same country measured at the end of fiscal year t
LoanRatio	A bank's total loans to its total deposits for the same period.
CapitalRatio	The percentage of a bank's capital to its risk-weighted assets.
<b><i>Board-level variables</i></b>	
IndepDirector	The number of independent directors on the board of directors as a proportion of the number of board members.
ForeignDirector	The number of foreign directors on the board of directors as a proportion of the number of board members.
FemaleDirector	The number of female directors on the board of directors as a proportion of the number of board members.
BoardSize	Number of board members.
Meetings	Number of meeting in each fiscal year.
Duality	A firm with CEO and chairman being the same person is scored as 1, otherwise 0.

Table 2 shows the definitions for each of the variables used in this study.

Table 3 displays the statistic descriptions of each variable. In this study, we measure bank performance using four proxies. Two are accounting ratios: return on equity (*ROE*) and sales on asset (*SOA*). The other two are market ratios: Tobin's Q and the annual holding period return.

**Table 3: Descriptive statistics**

Variables	N	Minimum	Maximum	Mean	Std. Deviation
<b><i>Bank performance variables</i></b>					
ROE	320	-0.180	0.430	0.100	0.030
SOA	320	0.006	1.944	0.447	0.216
TBQ	320	3.146	15.905	8.400	0.084
HPR	320	-0.359	0.740	0.032	0.039
<b><i>Proxies for royal family connection</i></b>					
RoyalDirectorRatioRatio	320	0	0.9	0.45	0.15
RoyalChair	320	0.000	1.000	0.483	0.500
RoyalOwnership	320	0.000	0.91160	0.60081	0.16229
<b><i>Firm-level variables</i></b>					
LnAsset	320	20.012	34.736	24.922	1.698
CashOverAsset	320	0.000	0.933	0.153	0.117
FirmAge	320	7.000	29.000	17.000	8.450
HHI	320	0.021	1.000	0.071	0.059
LoanRatio	320	0.100	0.740	0.540	0.080
CapitalRatio	320	-0.120	0.310	0.060	0.030
<b><i>Board-level variables</i></b>					
IndepDirector	320	0.000	0.410	0.180	0.110
ForeignDirector	320	0.000	0.130	0.040	0.020
FemaleDirector	320	0.000	0.200	0.160	0.050
BoardSize	320	3.000	18.000	7.440	1.450
Meetings	320	1.000	22.000	6.040	1.230
Duality	320	0.000	1.000	0.090	0.050

We use ROE instead of ROA because for a bank, the assets are the financial instruments that either the bank is holding (its reserves) or those instruments where other parties owe money to the bank. Assets are used by businesses to generate income. Loans and securities are a bank's assets and are used to provide most of a bank's income. However, not all assets in banks can be used to earn income, because banks must have cash to satisfy cash withdrawal requests of customers. Since not all asset can be used to generate income it is more reasonable to use ROE rather than ROA.

Since all commercial banks in the GCC are public listed, market-based data is readily available. Many regions do not have such a privilege because of the existence of privately owned banks. For example, 60% of banks in the US is not listed in stock market. (Kwan, 2004).

To measure the board member connection to royal family, we use three royal family related variables. This includes the proportion of directors on the board who are related

to the royal family (*RoyalDirectorRatio*), a dummy variable that captures the existence of a board chaired by a royal family member (*RoyalChair*), and the share of bank ownership held by a royal family member (*RoyalOwnership*). Our main control variables include six firm level variables. *LnAsset* captures the bank size, *CashOverAsset* captures the liquidity, *FirmAge* captures the trend of performance, and *HHI* captures the market share. The variables *LoanRatio* and *CapitalRatio* are included, as they are commonly used variables to captures bank soundness.

Table 4 shows the results of correlation analysis, all coefficients are lower than 0.7, suggesting that our models have no multicollinearity issues.

To improve the robustness of our findings, we also include five board level control variables to make sure our baseline results remain consistent with these additional controls. These variables are defined in Table 2 and reflect the age, total assets and liquidity of the bank, as well as the loan ratio, capital ratio and level of competition.

Equation 1 is the baseline model we use to check our first hypothesis, to determine whether the presence of a royal family member on the board of directors positively impacts bank performance:

$$Performance_{it} = \beta_{1it} + \beta_2 RoyalDirectorRatio_{it} + \sum \beta_k Control_{it} + \varepsilon_{it} \quad (1)$$

We further run two additional tests to check whether the role of royal family director is stronger with the increasing share ownership (Equation 2) and with the existence of a royal family board chair (Equation 3). Each specification includes a cross-product with the *RoyalDirectorRatio* explanatory variable to allow for the influence of this variable to either enhance or mitigate the net influence of either variable. These specifications appear below:

$$Performance_{it} = \beta_{1it} + \beta_2 RoyalDirectorRatio_{it} + \beta_3 RoyalOwnership_{it} + \beta_4 (RoyalDirectorRatio_{it} \times RoyalOwnership_{it}) + \sum \beta_k Control_{it} + \varepsilon_{it} \quad (2)$$

$$Performance_{it} = \beta_{1it} + \beta_2 RoyalDirectorRatio_{it} + \beta_3 RoyalChair_{it} + \beta_4 (RoyalDirectorRatio_{it} \times RoyalChair_{it}) + \sum \beta_k Control_{it} + \varepsilon_{it} \quad (3)$$

**Table 4: Correlation** - This table presents pairwise Pearson correlations for all regression variables used in this paper.

Variables		1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18	19
1	ROE	1																		
2	SOA	0.760	1																	
3	TBQ	0.450	0.654	1																
4	HPR	0.741	0.552	0.328	1															
5	RoyalDirectorRatio	0.080	0.120	0.06	0.062	1														
6	RoyalChair	0.082	-0.041	-0.157	0.014	-0.372	1													
7	RoyalOwnership	0.073	0.044	0.023	0.044	0.005	-0.061	1												
8	LnAsset	0.063	0.157	0.018	0.074	-0.009	0.004	0.016	1											
9	CashOverAsset	0.005	-0.003	0.438	0.039	0.921	-0.34	0.006	-0.007	1										
10	FirmAge	0.068	-0.055	0.361	0.394	0.204	0.13	0.032	0.101	0.183	1									
11	HHI	0.011	-0.004	-0.016	0	-0.027	0.013	-0.005	0	-0.025	-0.052	1								
12	LoanRatio	0.053	0.454	0.169	0.019	0.139	0.022	0.009	-0.172	0.125	0.287	-0.052	1							
13	CapitalRatio	0.105	0.009	0.22	0.048	0.454	-0.14	-0.027	0.029	0.397	0.203	0.009	0.029	1						
14	IndepDirector	-0.009	-0.001	-0.006	-0.002	-0.005	-0.008	-0.001	-0.001	-0.008	-0.037	0.07	-0.019	-0.005	1					
15	ForeignDirector	0.031	-0.171	0.044	-0.038	-0.007	-0.083	0.026	-0.003	-0.006	-0.133	-0.004	-0.033	-0.112	-0.008	1				
16	FemaleDirector	-0.034	-0.012	-0.01	-0.009	0.02	-0.055	0.034	0.009	0.016	-0.034	-0.001	-0.018	0.025	-0.001	-0.021	1			
17	BoardSize	-0.004	0.041	0.135	0.066	0.203	-0.002	0.069	0.029	0.185	0.156	-0.014	0.041	0.146	-0.001	-0.014	-0.02	1		
18	Meetings	-0.028	0.146	0.001	-0.049	0.111	-0.171	0.231	-0.012	0.095	-0.148	0.003	-0.021	-0.059	-0.004	0.062	-0.025	0.16	1	
19	Duality	0.003	-0.012	0.06	0.037	0.09	-0.072	0.036	0.006	0.075	0.017	-0.006	0.002	-0.01	-0.001	0.032	0.017	-0.013	0.061	1

All variables are defined in Table 2.

## 5. Empirical results and Analysis

**Table 5: Impact of royal family director to bank performance**

Model	1	2	3	4	5	6	7	8
Dependent Variables	ROE	SOA	TBQ	HPR	ROE	SOA	TBQ	HPR
RoyalDirectorRatio	0.00621*** (0.00548)	0.00850*** (0.00210)	0.00200*** (0.00045)	0.00160*** (0.00039)	0.00601*** (0.00511)	0.00831*** (0.00180)	0.00200*** (0.00040)	0.00171*** (0.00410)
LnAsset	0.00143*** (0.00471)	-0.0312* (0.01710)	0.0148*** (0.00473)	0.00311 (0.00279)	0.0135*** (0.00471)	-0.0317* (0.01710)	0.0143*** (0.00471)	0.00255 (0.00280)
CashOverAsset	0.00311 (0.0279)	0.00220*** (0.0000)	-0.0312* (0.1710)	-0.10329 (0.1862)	0.0312 (0.0211)	0.0210* (0.0117)	-0.317* (0.1710)	-0.106 (0.1860)
FirmAge	-0.0747*** (0.0119)	0.0127 (0.0140)	0.0311 (0.0279)	0.29396*** (0.1057)	-0.0740*** (0.0101)	0.1214* (0.0714)	0.0255 (0.0280)	0.296*** (0.1060)
HHI	-0.224 (0.3210)	-0.0152 (0.0604)	-0.06647** (0.0281)	0.02197 (0.1880)	-0.226 (0.3440)	0.0251 (0.0670)	-0.0662** (0.0281)	0.0189 (0.1880)
LoanRatio	0.1452*** (0.0178)	0.3125*** (0.0624)	3.06411*** (0.6877)	0.08466 (0.0554)	0.1455*** (0.0178)	0.1452*** (0.0133)	2.987*** (0.6880)	0.0825 (0.0553)
CapitalRatio	0.0401*** (0.0001)	0.0311 (0.0279)	-0.0349 (0.2590)	0.00609 (0.0679)	0.0411*** (0.0001)	0.0255 (0.0280)	0.00311 (0.0679)	0.00409 (0.0679)
IndepDirector					0.0047*** (0.0043)	1.569* (0.8980)	0.0822 (0.2260)	0.104 (0.2260)
ForeignDirector					-0.0160* (0.0095)	-0.542*** (0.1880)	0.084 (0.0554)	0.0853 (0.0554)
FemaleDirector					0.0000** (0.0000)	-0.0328*** (0.0089)	-0.279 (0.1840)	0.0245 (0.1880)
BoardSize					-0.0875* (0.0512)	0.148*** (0.0422)	-0.288 (0.1850)	0.0764 (0.2260)
Meetings					0.0150** (0.0000)	0.154*** (0.0423)	0.0853 (0.0554)	-0.279 (0.1840)
Duality					-0.1123 (1.2815)	0.0847 (0.0554)	-0.0328*** (0.0089)	0.084 (0.0554)
Constant	0.0401*** (0.0001)	0.00323 (0.0026)	4.465*** (1.1070)	0.154*** (0.0423)	0.0401*** (0.0001)	0.00323 (0.0026)	4.457*** (1.1070)	0.148*** (0.0422)
Year Fixed Effect	Yes							
Industry Fixed Effect	Yes							
Observations	320	320	320	320	320	320	320	320
R-squared	0.20	0.06	0.15	0.16	0.25	0.09	0.18	0.2

This table reports the regression results of royal director ratio on firm's performance using a fixed-effect panel data. Our sample includes 320 firm-year observations of GCC publicly traded commercial banks from 2013 to 2018. All variables are defined in Table 2. Standard errors appear in parentheses.  $p < 0.01$ ;  $p < 0.05$ ;  $p < 0.1$ .

Table 5 reports the panel data regression results based on Equation (1). Model specifications 1 – 4 report the results using firm level control variables. Model specifications 5 – 8 report the results by including additional board level control variables as a robustness check. These variables include the number of independent directors, foreign directors and female directors as a ratio of the total number on the board. Other variables include the size of the board and the frequency of scheduled meetings. These results are all controlled for time invariant and industry invariant factors by using a fixed effects specification.

All models show that the higher the ratio of royal family director on board, the better the bank performance. Models 1 - 4 indicate that every one percent increase in the proportion of royal director representation is associated with 0.621 percent increase in *ROE*, with 0.85 percent increase in sales over asset, with 0.2 percent increase in Tobin's Q, and a 0.16 percent increase in annual holding period return. Models 5 – 8 show the consistent results with little variation in the coefficients of *RoyalDirectorRatio*.

**Table 6: SGMM – Robustness check**

Model	1	2	3	4	5	6	7	8
Dependent Variables	ROE	SOA	TBQ	HPR	ROE	SOA	TBQ	HPR
RoyalDirectorRatio	0.0454*** (0.0066)	0.14856*** (0.0422)	0.0378*** (0.0061)	0.0328*** (0.0089)	0.0437*** (0.0066)	0.155*** (0.0423)	0.0373*** (0.0061)	0.0331*** (0.0089)
LnAsset	-0.00348 (0.0994)	0.0295 (0.1880)	-1.321*** (0.2470)	0.02197 (0.1880)	0.00937 (0.0997)	0.0231 (0.1880)	-1.326*** (0.2470)	0.0295 (0.1880)
CashOverAsset	-0.352 (0.3120)	0.0846 (0.2260)	-0.417*** (0.0770)	0.08537 (0.2258)	-0.321 (0.3110)	0.0834 (0.2260)	-0.417*** (0.0770)	0.0846 (0.2260)
FirmAge	0.0911** (0.0450)	-0.288 (0.1850)	0.143*** (0.0471)	-0.2792 (0.1844)	0.0965** (0.0449)	-0.271 (0.1850)	0.148*** (0.0473)	-0.288 (0.1850)
HHI	-0.0875*** (0.0171)	0.0853 (0.0554)	-0.312* (0.1710)	0.08466 (0.0554)	-0.0874*** (0.0172)	0.0855 (0.0554)	-0.317* (0.1710)	0.0853 (0.0554)
LoanRatio	0.71 (0.8760)	0.0207 (0.1880)	0.0311 (0.0279)	-0.03292*** (0.0089)	0.8 (0.8750)	0.0295 (0.1880)	0.0255 (0.0280)	-0.0328*** (0.0089)
CapitalRatio	-1.469*** (0.5270)	2.994*** (0.6880)	-0.0747*** (0.0119)	0.03673 (0.0343)	-1.542*** (0.5270)	3.042*** (0.6880)	-0.0727*** (0.0119)	0.0363 (0.0343)
IndepDirector					-0.00303 (0.0051)	1.569* (0.8980)	1.981*** (0.4990)	0.0853 (0.2260)
ForeignDirector					0.712*** (0.1630)	0.938* (0.5470)	-0.231 (0.3210)	-0.279 (0.1840)
FemaleDirector					0.0802 (0.0879)	-0.542*** (0.1880)	-0.00269 (0.0033)	0.0847 (0.0554)
BoardSize					-0.0153 (0.1410)	0.0178 (0.0443)	0.365*** (0.1050)	-0.0331*** (0.0089)
Meetings					0.0321 (0.2890)	0.303** (0.1500)	-0.0152 (0.0604)	0.0369 (0.0343)
Duality					-0.181* (0.1050)	0.237 (0.1500)	-0.0944 (0.0889)	0.148*** (0.0422)
Constant	6.935*** (2.0860)	0.00324 (0.0026)	-0.103 (0.0906)	0.0853 (0.2260)	6.666*** (2.0910)	0.00754 (0.0098)	-0.0693 (0.1870)	0.00321 (0.0026)
CSR AR(1)	0.206*** (0.0251)	5.994*** (0.6880)	0.0331*** (0.0089)	4.465*** (1.1070)	0.205*** (0.0251)	6.34*** (3.4260)	0.0251*** (0.0067)	4.474*** (1.1070)
Year Fixed Effect	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Industry Fixed Effect	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Observations	320	320	320	320	320	320	320	320
Sargan–Hansen test (p-value)	1	1	0.45	0.67	1	1	0.4600	0.7500
Chi-Sq	149.87	173.1	154.55	165.44	148.56	174.56	158.61	166.23

This table reports the regression results of royal director ratio on firm's performance using system GMM. Our sample includes 320 firm-year observations of GCC publicly traded commercial banks from 2013 to 2018. *Annual Median of RoyalDirectorRatio by country* is used as instrumental variable All variables are defined in Table 2. Standard errors appear in parentheses.  $\bar{p}<0.01$ ;  $\bar{p}<0.05$ ;  $\bar{p}<0.1$ .

To check whether the results on Table 5 remain consistent after accounting for endogeneity issues, we run a series of SGMM tests based on Equation (1). Arellano and Bond (1991) pioneered the applied GMM estimation for panel data. In the GMM approach proposed by Arellano and Bover (1995) and Blundell and Bond (1998), the lagged values of the dependent variable are used as instruments to account for the endogeneity problem. System GMM attracts many attentions in the past empirical studies. Bond (2002) concluded that the estimator may be biased if the data are not stationary while a higher accuracy of the estimation result can be achieved by using the system GMM, as the method uses a higher number of instruments and connects the regression in the levels with regressions in the first-differences. Moreover, the system GMM is comparatively better because when the time series is a random walk process, the instruments in the level estimation are efficient predictors for the endogenous variables (Blundell and Bond, 1998). Therefore, this study used the system GMM as a robustness check.

We use yearly median of *RoyalDirectorRatio*, sorted by country, as the instrument in our regressions. The results of SGMM are recorded in Table 6. All models in Table 6 show consistent results with those appearing in Table 5. Thus, findings from Table 5 and Table 6 both support our first hypothesis that the presence of royal family connections in the board has a positive impact on commercial banks' performance.

Next, we check on the moderation effects of other characteristics related to royal family to royal director and bank performance. In the GCC region economies, when a royal family gains greater control on a board of a bank, the bank becomes an important asset to the royal family. This implies that the royal family will be likely to channel more resources to improve bank performance to achieve its unique goals. Such goals include making the bank a facilitating station for implementing a ruler's social responsibilities and to uphold the good public image of the royal family. We argue that whatever factors that enlarge the controlling power of a royal family on a board, such factors could also moderate the positive impact of royal director to bank performance. Here we use two variables related to royal family as moderators: the royal family's ownership share of the bank, and a dummy that captures whether the chairman position is held by royal family member.

Table 7 show the moderation results by examining the direct influence of royal family member ownership on bank performance, as well as the indirect influence as a moderating factor affecting the net influence of *RoyalDirectorRatio* on bank performance. As in the previous tables, we report the results of two sets of analyses. One set of tests (models 1 – 4) use firm level control variables, and another set of tests (models 5 – 8) use both firm and board level control variables. *RoyalOwnership* shows significant impact in increasing *SOA* (at the 10% confidence level) and *HPR* (1% confidence level). Further, it shows positive moderating effects for *RoyalDirectorRatio* on all models.

**Table 7: Moderating effects of share ownership of royal family on royal director ratio**

Model	1	2	3	4	5	6	7	8
Dependent Variables	ROE	SOA	TBQ	HPR	ROE	SOA	TBQ	HPR
RoyalDirectorRatio	0.00617*** (0.00512)	0.0856*** (0.00211)	0.00240*** (0.00043)	0.00165*** (0.00029)	0.00602*** (0.00411)	0.0846*** (0.00140)	0.00230*** (0.00030)	0.00161*** (0.00360)
RoyalOwnership	0.00311 (0.0679)	1.569* (0.8980)	-0.062 (0.0661)	0.295*** (0.1060)	0.00558 (0.0679)	0.938* (0.5470)	-0.0614 (0.0661)	0.293*** (0.1060)
RoyalDirectorRatio*RoyalOwnership	0.00113* (0.0006)	0.000327** (0.0001)	0.000286** (0.0001)	0.250*** (0.0422)	0.0101* (0.0057)	0.000286** (0.0001)	0.317* (0.1710)	0.148*** (0.0422)
Firm Control	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Board Control	No	No	No	No	Yes	Yes	Yes	Yes
Year Fixed Effect	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Industry Fixed Effect	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Observations	320	320	320	320	320	320	320	320
R-squared	0.24	0.10	0.18	0.18	0.27	0.12	0.18	0.19

This table reports the regression results of moderation effect of royal family ownership to royal director ratio and firm's performance using a fixed-effect panel data. Our sample includes 320 firm-year observations of GCC publicly traded commercial banks from 2013 to 2018. All variables are defined in Table 2. Standard errors appear in parentheses.

□□□  $p < 0.01$ ; □  $p < 0.05$ ; □  $p < 0.1$ .

We redo the same analysis by using moderators in Table 8. Results in Table 8 show the moderation analysis of royal family board chair on royal director ratio and bank performance. *RoyalChair* shows significant impact in decreasing HPR (at the 5% confidence level) and shows positive moderating effects to *RoyalDirectorRatio* on all models.

**Table 8: Moderating effects of royal board chair on royal director ratio**

Model	1	2	3	4	5	6	7	8
Dependent Variables	ROE	SOA	TBQ	HPR	ROE	SOA	TBQ	HPR
RoyalDirectorRatio	0.0621*** (0.0548)	0.850*** (0.0210)	0.0200*** (0.0045)	0.0160*** (0.0039)	0.0601*** (0.0511)	0.831*** (0.0180)	0.0200*** (0.0040)	0.0171*** (0.0410)
RoyalChair	0.08537 (0.2258)	-0.28 (0.1840)	-0.062 (0.0661)	-0.0660** (0.0281)	-0.271 (0.1850)	-0.284 (0.1840)	-0.0667 (0.0661)	-0.0690** (0.0281)
RoyalDirectorRoyal*RoyalChair	0.296*** (0.1060)	0.0328*** (0.0089)	0.216*** (0.0807)	0.0669** (0.0281)	0.293*** (0.1060)	0.0331*** (0.0089)	0.212*** (0.0807)	0.0658** (0.0281)
Firm Control	Yes							
Board Control	No	No	No	No	Yes	Yes	Yes	Yes
Year Fixed Effect	Yes							
Industry Fixed Effect	Yes							
Observations	320	320	320	320	320	320	320	320
R-squared	0.22	0.12	0.16	0.15	0.25	0.14	0.16	0.14

This table reports the regression results of moderation effect of royal family chair of board of directors to royal director ratio and firm's performance using a fixed-effect panel data. Our sample includes 320 firm-year observations of GCC publicly traded commercial banks from 2013 to 2018. All variables are defined in Table 2. Standard errors appear in parentheses.  $\bar{p}<0.01$ ;  $\bar{p}<0.05$ ;  $\bar{p}<0.1$ .

## 6. Conclusions

Using a sample comprising 320 firm-year observations for commercial banks in the GCC countries, we find empirical support for the theory that bank performance is positively affected by the presence of ruling family members of the banks' board of directors. This impact was estimated using four separate measures of financial performance: return on equity (ROE), sales on assets (SOA), Tobin's Q, and the annual holding period return. These empirical results are consistent across all four different proxy measures for bank performance. Although prior studies have examined the relationship between board composition and bank performance in different geographies (Agoraki et al., 2009; Altunbas et al., 2001; Casu & Girardone, 2009; Claessens et al., 2008; Dinç, 2005), this is the first study that explicitly examines the relation between royal family political connections and banks' performance in the GCC, which is a prominent developing country region.

Our study makes the following contributions to the existing literature. First, our analysis supports some of the prior studies that find a positive impact arising from the political connections of board members on bank's performance (Tanna et al., 2011; Chaaban, 2016). We provide empirical evidence that political connections appear to align with shareholders goals, which corroborates the findings of both Fisman (2001) and Johnson and Mitton (2003). Second, our study corroborates other studies (Dinç, 2005; Faccio, 2006) by confirming that political connections tend to improve banks' profitability and increase their lending capacity. Third, our study supports RDT tenets, which proposes that firms with political connections can gain a competitive edge through special treatments from government and industry connections. Further, our results are proven to be robust after checking on causality and controlling for the endogeneity of our model.

However, our results are limited in their applicability to the larger population of commercial banks around the world. Our sample only uses data from GCC commercial banks, which all operate under a relatively homogeneous set of cultural and political institutions, as well as a much less diverse set of sources for economic growth. To this end, we recommend further exploration of the relationship between political connections and firm's performance using samples from different geographies, especially among the developing countries, to secure the application of our findings in similar environments. The results of this study should be informative for various commercial bank constituencies, such as bank shareholders, ruling family members, board members and capital market participants, to help predicating the firms' future upon the appointment of ruling family members in their boards.

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