Further Evidence on the Link between Firm's Control Mechanisms and Firm Financial Performance: Sultanate of Oman

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ABSTRACT – Based on the agency theory perspective and its corporate governance problem, the current study investigated how control mechanisms affect firm financial performance with special concentrate on the role of audit committee on the enhancement of firm financial performance. The empirical findings of this study based on the listed companies in the Sultanate of Oman revealed that the control mechanisms, including committee size and board independence, positively enhance financial performance represented by ROE and therefore this leads to encourage firms to focus on such mechanisms. By contrast, audit size, board size and board independence are totally not motivated to engage with financial performance due to the insignificant link with ROA. On the other hand, a negative correlation has been found between board meeting and financial performance represented by ROE. The practical evidence of the implications by the current study found that for improvement of firm financial performance; that even though if most of the GCC governments recently have focused on corporate social responsibility because largely voluntary nature of corporate social responsibility, they should focus of the control mechanisms that suggested by the current study to play a significant role for enhancing firm financial performance.

INTRODUCTION

Control mechanisms have helped solving several problems related to regulations, laws, and declining performance and in addition to matters related to corporate governance risk management via pursuing to reach a positive impact of companies’ performance (Alabdullah, Ahmed, & Muneerali, 2019; Alabdullah, Ahmed, & Nor, 2019). Therefore, control mechanisms have been used by the managements to have a good level of effectiveness, efficiency, and transparency in their companies in order to enhance the companies’ performance (Alabdullah, Laadjal, Ahmed, & Al-Asadi, 2018). However, some listed companies are facing problems and lack in their financial performance because of many reasons such as manipulation and fraud in the financial reporting and this leads to the weakness in the financial performance in the listed companies in the Sultanate of Oman and other Gulf Cooperation Council (GCC) countries.

As it concludes by trends of the previous studies in the literature review, it is obvious that one of the main purposes to strengthen reforms in Oman is going forward to improving firm financial performance (Ahmed et al., 2020). As in other emerging economies, the non-financial sector has been related to the general policy aims of obtaining higher level of economic enhancement and higher performance of the companies and reducing the poverty (Nagirikandalage, 2020). In developing markets including Oman, they mainly concern is toward control mechanisms including transparency practices (Aguilera, & Haxhi, 2019). Hereher et al. (2020) mentioned that Oman is a distinguished country with a high geographical and economic position and there are three bodies of water overlooking the Sultanate of Oman: the Arabian Gulf, the Arabian Sea, and Bahr. It also has a coastal frontage of more than 3000 km. The important and remarkable note is that the key objective of the Omani government is always towards building a prosperity country that can contribute positively to the overall great and development of the Sultanate of Oman (Al-Issa, 2020). The current study contributes to add knowledge to the literature review by filling the gap that could be considered as observation in the literature as regards financial performance in non-financial companies in the sultanate of Oman at the empirical and theoretical level. In that,
from theoretical level. It adds knowledge to the current literature via adopting and testing its independent and dependent variables, where there has been a lack in the literature review in testing such variables. In addition, it helps management and policy makers to focus on some important control mechanisms that should be applied by the management of the non-financial companies in Oman and this reflects the empirical contribution perspective.

The rest sections of the paper are organized as follow: previous studies that represented section 2 as a literature review. While section 3 illustrates the method of the current study. In addition, section 4 explains the results. For section 5 and 6: they provide both discussions and conclusions of the present study.

LITERATURE REVIEW

This study focused on what have been done recently in the literature review in the last three years regarding the control mechanisms and their impact on firm financial performance in GCC. Control mechanisms have several instruments that are useful for maximizing for performance and firm value as well (Ahmed, Alabdullah, Thottoli, and Maryanti, 2020; Alabdullah, Nor, & Ries, 2018).

A study done by Al-ahdal, Alsamhi, Tabash, and Farhan, (2020) investigated the impact of control mechanisms on corporate performance in the listed companies for both those belong to Indian and also listed companies in the GCC. The findings reveal that board accountability and audit committee have no effect on firm performance measured by Tobin’s Q and ROE. Forcadell, Sanchez-Riofrío, Guerras-Martín, and Romero-Jordán, (2020) study the impact institutional environment business strategy and firm performance. The findings illustrate that there is a significant link between them. Another study tested the the relationship between corporate governance and firm performance in Oman contest (Ahmed et al., 2020). The findings revealed a positive between the set of the independent variables represented by ownership, board size, audit committee and gender and firm financial performance. Akira, (2020) investigated the impact of mergers and acquisitions on the profitability and the results show that there is no significant impact in return on assets as indicator of the profitability. Also, recently, a study done by Kushkowski, Shradrer, Anderson, and White, (2020) They evaluate set of control mechanisms via using bibliometric analysis for the articles that have been done by the researchers. The results illustrate that control mechanisms are far more interdisciplinary than previously thought. Naciti (2019) investigated the impact of board of directors’ composition on firms’ sustainability performance. The findings revealed that there is a negative link between the independence and sustainability performance. Gao, Huang, and Yang, (2019) examined the relation between ownership structure and firm performance and the findings show that there is positive link between ownership structure and market responses. Garcia-Sánchez, Hussain, and Martínez-Ferrero, (2019) tested the ability of internal control to help firms reduce agency problems and the impact on both environmental and social performance. They found a strong relationship between CEO ability and internal control mechanisms in enhancing firm performance. Abdallah and Ismail (2017) explore the link of ownership and the levels of concentrated ownership in form performance. The findings show that there is a positive link between their quality and firm performance. Similar research has been done by Pillai and Al-malkawi. (2017) who tested the impact of internal control mechanisms on firm performance in the GCC countries. They found that audit type, board size, and leverage have positive impact on performance of the firms listed in the GCC countries. Based on the above, it could be realized that control mechanisms have effective role in monitoring the firms and enhancing firm performance. Thus, the current study developed these two hypothesis:

H1: A positive link between control mechanisms and firm performance (ROA).

H2: A positive link between audit committee and firm performance (ROA).

UNDERPINNING THEORY

Agency theory notion lies in separating the role between the agent and the principal to limit the behaviour of the agent (managers) for not maximizing their wealth of the account of the wealthiest the principal (shareholders). Therefore, there is eternal conflict between these two parties represented by the conflict of interests. Thus, control mechanisms of corporate governance came to be as a key solution for solving problems that arise between them (Gibson, 2003).

Based on agency theory that strongly suggests that there should be a positive link between board independence, board meeting, and firm performance (Rashid, 2018). Tobin’s q is a proxy for firm value as mentioned by (Lo & Sheu, 2007). In the same line, Thomsen and Pedersen (2006) mentioned that Tobin’s Q is proper to be as measurement of stock market value. Our study excluded Tobin’s Q because this measurement is for firm value and it is market-based value, while the aim of our study is accounting based value that represents the form performance.

METHODOLOGY

This study applied study in 90 companies listed in Muscat Securities Market for the fiscal year 2019. The data collection was based on reports issued online from the website of Muscat Securities Market (MSM). Our study is quantitative and the data collection for one year of 2019 as a cross sectional study. It utilized structural Equation Modelling (SEM) with Partial Least Square (PLS) approach to analyse the hypotheses of the current study.
This measurements of the current study for its independent and dependent variables that represented by the determinants of control mechanisms, audit committee and financial performance are shown below:

1. Board Size (B-SZ): measurement of the board size is based on the number of board members.
2. Board Independence (B-IND): measurement is based on the number of independent board of directors’ members.
3. Board Meeting (B-MT): measurement is based on the number of board meetings.
4. Audit Committee Size (AC-SZ): measurement is based on the number of members of audit committees.
5. Audit Committee Independence (AC-IND): measurement is based on the number of independent audit committee members.
6. Audit Committee Meeting (AC-MT): measurement is based on the number of audit committee meetings.

Measurement of the dependent variables:
1. Return on Assets (ROA): measurement of ROA is based on the net income / total assets.
2. Return on Equity (ROE): measurement of the ROE is based on net income / total equity.

The models are explained by the below equations:

\[ ROA = \alpha + \beta_1 INO + B_2 FRO + B_3 FZ + \epsilon \]  
(1)

\[ ROE = \alpha + \beta_1 INO + B_2 FRO + B_3 FZ + \epsilon \]  
(2)

RESULTS

The sample was represented by listed companies in Muscat Stock Market that belongs to financial, service, and industrial sectors.

<table>
<thead>
<tr>
<th>No</th>
<th>Sector</th>
<th>Companies Numbers</th>
<th>Sample</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Financial</td>
<td>34</td>
<td>30</td>
</tr>
<tr>
<td>2</td>
<td>Services</td>
<td>39</td>
<td>30</td>
</tr>
<tr>
<td>3</td>
<td>Industrial</td>
<td>42</td>
<td>30</td>
</tr>
<tr>
<td></td>
<td>Total</td>
<td>115</td>
<td>90</td>
</tr>
</tbody>
</table>

Descriptive Statistics

Regarding ROA and ROE as dependent variables, the results of this test show that the average of ROA is 12% and its standard dev. (SD) is 0.064. In addition, value of 24% and 11% represent the Max. and Min. Where the result revealed an average of ROE for 30% with SD of 0.114. Also, the Min. And Max. value show that ROE is 35% and 27%. While the values for the depended variables were as shown:
The average was equal to 5.17% and the SD was 1.700; Board size was 7.20% and SD was 1.48; The average of Board meeting was 6.068% and its SD was 1.568. Audit size was 3.32% and SD was 0.559; Independence of Audit was 54% and SD was 0.16; Independence of Board was 0.68% and SD was 0.145.

<table>
<thead>
<tr>
<th>Variables</th>
<th>Mean</th>
<th>Min</th>
<th>Max</th>
<th>Standard-D</th>
</tr>
</thead>
<tbody>
<tr>
<td>ROA</td>
<td>0.012</td>
<td>-0.241</td>
<td>0.118</td>
<td>0.064</td>
</tr>
<tr>
<td>ROE</td>
<td>0.033</td>
<td>-0.352</td>
<td>0.275</td>
<td>0.114</td>
</tr>
<tr>
<td>B-SZ</td>
<td>7.220</td>
<td>5.000</td>
<td>10.000</td>
<td>1.486</td>
</tr>
<tr>
<td>B-IND</td>
<td>0.683</td>
<td>0.253</td>
<td>1.000</td>
<td>0.145</td>
</tr>
<tr>
<td>B-MT</td>
<td>6.068</td>
<td>4.000</td>
<td>11.000</td>
<td>1.568</td>
</tr>
<tr>
<td>AC-SZ</td>
<td>3.321</td>
<td>3.000</td>
<td>5.000</td>
<td>0.559</td>
</tr>
<tr>
<td>AC-IND</td>
<td>0.548</td>
<td>0.282</td>
<td>1.000</td>
<td>0.168</td>
</tr>
<tr>
<td>AC-MT</td>
<td>5.077</td>
<td>2.000</td>
<td>11.000</td>
<td>1.704</td>
</tr>
</tbody>
</table>
Discriminant Validity

In PLS for testing the discriminant validity, there are standards applied. The square-root of every AVE for every construct must have a high correlation level including the other constructs. Thus, to deal with discriminant validity, the square root of each construct in its AVE has to be compared versus the constructs’ correlations for all other constructs.

### Table 3. Discriminant Validity Constructs

<table>
<thead>
<tr>
<th>ROA</th>
<th>ROE</th>
<th>B-SZ</th>
<th>B-IND</th>
<th>B-MT</th>
<th>AC-SZ</th>
<th>AC-IND</th>
<th>AC-MT</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.000</td>
<td>0.833</td>
<td>0.085</td>
<td>0.103</td>
<td>-0.183</td>
<td>0.071</td>
<td>-0.062</td>
<td>-0.216</td>
</tr>
<tr>
<td>1.000</td>
<td>1.000</td>
<td>0.174</td>
<td>0.269</td>
<td>-0.245</td>
<td>0.483</td>
<td>-0.194</td>
<td>0.224</td>
</tr>
<tr>
<td>1.000</td>
<td>0.078</td>
<td>0.281</td>
<td>-0.078</td>
<td>0.483</td>
<td>-0.065</td>
<td>0.476</td>
<td>-0.081</td>
</tr>
<tr>
<td>1.000</td>
<td>1.000</td>
<td>1.000</td>
<td>0.56</td>
<td>0.336</td>
<td>-0.139</td>
<td>0.098</td>
<td>1.000</td>
</tr>
</tbody>
</table>

**DISCUSSION AND CONCLUSION**

In SMS in Oman context, this study tested the effect of control mechanisms (CM) and audit committee (AC) features on financial performance. Thus, the objective of our study is to investigate the independent variables represented by CM and AC on dependent variable; financial performance represented by ROA and ROE in Omani companies. In another word, the independent variables of this study which are CM that represented by size of board of director, meeting of the board and its independence) and in addition to the audit committee (AC) which is represented by its size, meeting and independence.

The results indicate a significant and positive relation between the independence of board and financial performance which shows a value of p<0.05 and t=1.755. This finding is in line with a study done by Naciti (2019). This shows the essential role of this independent variable in enhancing financial performance. Also, for another independent variable which is audit size which is considered as an important tool of audit quality. The measurement of the variable is via computing a number of persons that service in this committee audit in the firm as explained by Nuryanah, & Islam, (2011). In addition, the results revealed a significant and positive relationship between size of audit committee size and financial performance as the values are P<0.05 and t=1.634 with the performance indicator which is ROE with value of P<0.05 and t=1.478. This revealed that when the size of audit committee is with several numbers of members this will lead to high performance of the companies in Oman, which is good indicators. This result is in line with a previous study of Ahmed, et al., (2020), and also with another study done by Pillai and Al-malkawi. (2017).

The main aim of the current study is to investigate the link between control mechanisms and audit features to enhance the achievements of the companies in Oman for the year of 2019. This study utilised meeting of board, size of board, independence of the board, audit committee size as independent variables for the control mechanisms and their impact on firm financial performance that represented by ROA and ROE. The results reveal that the size of the audit committee in the companies listed in MSM in Oman is positively related to both ROA and ROE. Also, the findings show that there is a positive and significant relationship between independence of the board and ROE. Moreover, the results show a significant and positive between the meeting of board committee and ROE. We realized from our results thy the majority of the hypotheses are not supported. In that, size of the board and both ROE and ROA in addition the independence and meeting of the committee are not supported in their link with ROA, our study found that there is a positive link between these two independent variables and form performance, therefore, our result is in line with the notion of agency theory. Our work introduces an understanding of the control mechanisms’ elements beside audit comma features and their effect on financial performance in the companies listed in Oman market. Actually, there is a defense in the results among the companies, where some of them the relations were positive and others negative. So, this establish for a recommendation that there should be a moderator variable must be tested between the IVs and DVs of the present study by the future researchers.

**RECOMMENDATION**

The current work investigated the links among control mechanisms and audit features, and firm financial performance. The literature review in this area has faced a scarcity in investigating this link and their impact on financial performance as the current study fill the this gap via testing its variables: board diversity m, culture and review quality that all would strongly have a significant impact on firm financial performance. In addition, our study suggested to test the same variables but rather searching for another suitable theories such as stakeholder, supervision, and also others. Yet, the findings and recommendations of the current work must be explained in light of limitations that lead to create a fruitful
area for future studies. Firstly, the year that we collected the data from the companies is 2019 which means the current study applied across sectional study in collect and analyzing data of Omani companies. Secondly, we also strongly recommend the researchers to test the same variables that we used but in doing a comparative study between Oman and another country in the GCC. Thirdly, the model developed in the current study can be further extended via including another sector, such as financial sector.

LIMITATIONS OF THE STUDY

The model of the current study is not totally comprehensive. It involves a limited number of control mechanisms to make the empirical test of a variety control mechanisms factors among the model factors feasible. In addition, we applied the set of mechanisms on just non-financial sector while there is another sector that could also applied such mechanisms in it. Moreover, the study is cross sectional analysis while there is a panel analysis as well that could be done for a few numbers of years in the same sector and in another.

REFERENCES


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